IN THE

Supreme Court of the United States

OCTOBER TERM, A. D. 1933.

No. 548.

ILLINOIS BELL TELEPHONE COMPANY,
Appellant,

vs.

BENJAMIN F. LINDHEIMER, ERNEST J. KRUETGEN, ANDREW OLSON, G. GALE GILBERT, PHIL. W. COLLINS, PAUL SAMUELL and CHARLES E. BYRNE, the persons constituting the Illinois Commerce Commission of the State of Illinois, and OTTO KERNER, Attorney General of the State of Illinois,
Appellees,

and

CITY OF CHICAGO, a municipal corporation,
Appellee.

CROSS-APPEAL FROM DISTRICT COURT OF THE UNITED STATES, FOR THE NORTHERN DISTRICT OF ILLINOIS, EASTERN DIVISION (3746).

Brief and Argument for Illinois Commerce Commission, Attorney General of State of Illinois, and City of Chicago—Cross-Appellees.

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CROSS-APPEALS FROM DISTRICT COURT OF THE UNITED STATES, FOR THE NORTHERN DISTRICT OF ILLINOIS, EASTERN DIVISION (3746).

Brief and Argument for Illinois Commerce Commission, Attorney General of State of Illinois, and City of Chicago—Cross-Appellees.

EXPLANATION OF TERMS.

American Company	American Telephone & Telegraph Company.
Answer on Cross-Appeal	Brief and Argument herein following.
Appellants	Illinois Commerce Commission, Attorney General of State of Illinois, and City of Chicago, Appellants in Case Number 440 and Appellees in Case Number 548.
Appellants' Brief	Brief and Argument for Appellants on Appeal, Case Number 440.
Appellee	Illinois Bell Telephone Company, Appellee in Case Number 440 and Appellant in Case Number 548.
Appellee's Brief	Brief for Illinois Bell Telephone Company, Appellant on Cross Appeal, Case Number 548.
Appendix	Note: The Appendix is printed in the back of this Volume, *infra*, pages 99 to 112.
Appendix to Appellants' Brief	Appendix to Appellants' Brief and Argument on Appeal, Case Number 440.
Associated Companies	Licensee companies of the American Company in the United States.
Bluefield Case	*Bluefield Waterworks & Improvement Co.* v. *Public Service Commission of West Virginia*, 262 U. S. 679.

Minnesota Rate Cases .	*Minnesota Rate Cases,* 280 U. S. 352.
O. R.	Old Record, being Volumes I to VII of the record in the case of *Smith, et al.* v. *Illinois Bell Telephone Company* before this Court in the October Term 1930 (282 U. S. 133), containing the evidence introduced upon the 1929 hearing.
R. ... Record	Note: Roman numeral following "R." (for example, R. I) indicates Record Vol. I. Similarly R. I, 40—for example—indicates Record Vol. I, page 40.
United Railways Case .	*United Railways & Electric Co. of Baltimore* v. *West,* 280 U. S. 234.
Western	Western Electric Company, an Illinois corporation to 1915, and a New York corporation since 1915.

Brief On Behalf of Illinois Commerce Commission, Attorney General of State of Illinois and City of Chicago.*

PRELIMINARY STATEMENT.

The Brief of the Illinois Bell Telephone Company** on its Cross Appeal seeks to show that the findings of the District Court which failed to follow its presentation, erred to Appellee's prejudice and that such prejudicial errors supply a cushion to absorb any prejudice in its favor which may have resulted from the District Court's findings claimed by Appellants to be erroneous.

Appellee's Brief on Cross Appeal preserves the same lack of realism which permeated its presentation before the District Court, as shown in Appellants' Brief on Appeal before this Court (referred to herein as "Appellants' Brief").

Appellee's Brief on Cross-Appeal catalogues findings and decisions of the Commission and District Court in other hearings and of Commissions and Courts in other cases in support of its claims on License Contract. But Appellee does not point out the facts of the American Company's experience in respect thereto, made available to Courts and Commissions for the first time as a result of this Court's direction of December 1, 1930. These facts reveal that the Commissions and Courts in such other hearings and cases were imposed upon by Appellee and by the other Associated Com-

*Referred to herein as Appellants.

**The Illinois Bell Telephone Company, appellant in Case Number 548 and appellee in Case Number 440, is herein referred to as Appellee.

panies who made the presentations on License Contract, and that the findings and decisions based thereon jar one's sense of fair play.

Appellee's Brief on Cross-Appeal invokes an alleged "more notorious and greater decline in the market price of corporate securities" than the "general decline in corporate earnings" as found by the District Court for 1931 and 1932 in support of its claims on Fair Return for those years. But Appellee does not point out that the investor in its own securities could have sold in 1931 at a substantial profit its securities purchased at their offering in 1923 or in the years 1923 to 1926, inclusive, and even in the year 1929. Nor does Appellee point out the similar actual experience of other high grade securities as disclosed in the record, to which securities the alleged "notorious" decline had no application. Nor does Appellee point out that the cost of issuing such high grade securities was less in 1931 than in the years prior thereto; nor that a larger percentage of total financing in 1931 embraced high grade securities of the investment rating of those of Appellee than in the period prior to the depression. Nor does Appellee point out that the securities to which its alleged "notorious" decline had application were all of investment rating inferior to that of Appellee's securities as admitted by Appellee's experts on Fair Return.

Appellee's Brief on Cross-Appeal invokes its interpretation of the language of the Minnesota Rate Cases in support of its claims on Depreciation in Valuation. But Appellee points out neither the accounting practices to which such language had application, nor the accounting practices of Appellee which determine the proper basis for the de-

duction from rate base value new in arriving at the rate base. Such practices make its interpretation incongruous.

Appellee's Brief on Cross-Appeal invokes its interpretation of language of the Commission's Orders in support of its claims on Depreciation Expense allowances. But Appellee does not point out its own experience which is inconsistent with such interpretation.

Appellants' Answer herein to Appellee's Brief on Cross-Appeal points out these facts which Appellee disregarded.

Appellee's Brief on Cross-Appeal, as well as its presentation before the District Court, reveals that its contentions cannot be accepted without being checked against those facts of experience to which it has consistently failed and refused to give consideration, and for the recounting of which the voluminous record on Appeal is essential.

Summary of Argument.

APPELLEE'S CLAIMS COVERING LICENSE CONTRACT SERVICES AND PAYMENTS (Infra, 26).

Appellee's Position.

Appellee seeks through its cross-appeal to show that the District Court went out of its way to favor Appellants on all disputed items and otherwise erred to its prejudice. In support of its position, Appellee pointed out that:

I. The District Court allowed, as proper operating expense for the years 1929 to 1931, inclusive, the license payments which were less by $768,000 than the American Company's costs found by the District Court applicable thereto.

II. The District Court should have allowed as proper operating expense for the years 1923 to 1928, inclusive, the entire license payments, and not merely the American Company's costs applicable thereto as found by it. Such costs were less by $2,758,369 than such payments. The District Court should have followed its own findings on the 1929 hearing, and the many other cases which allowed the license payments in full.

III. The District Court should have allowed as proper the entire license payments for the years 1923 to 1928, inclusive, on the basis of the American Company's actual experience in respect to the License Contract during the entire period 1923 to 1931, inclusive.

IV. The District Court, in any event, should have allowed as additional costs the instrument, franchise, excise,

capital stock and income taxes of the American Company, as claimed by Appellee.

Appellants' Position.

Appellee has distorted the facts and misinterpreted the law, in that:

I. The American Company's costs found applicable to License Contract operations for the years 1929 to 1931, inclusive, were inflated by $2,558,000 through the inclusion therein of costs applicable to Holding Company and to Licensing of Inventions operations. The restriction, by the District Court of the allowance to the license payments merely reduced the amount of inflation contained therein by $768,000.

II. There was no legal basis to sustain the license payments in full for the years 1923 to 1927, inclusive, because:

A. Such payments exceeded by from $432,000 to $631,000 the amount required to pay (1) the American Company's expenses plus a reasonable return on its investment applicable to the License Contract operations, as found by the District Court; (2) the expenses and return applicable to its Holding Company and Licensing of Inventions operations; and (3) a portion of its appropriations to the Reserve for Contingencies.

B. The Commission's allowances and the District Court's determinations prior to the 1932 hearing covering telephone instrument rental, were revealed by the American Company's actual experience made available at the 1932 hearing, to have been grossly excessive—the Commission's allowances for rental yielding the American Company at least 45.7% and the District Court's determi-

nations, based on Appellee's showing, 42.2% on the American Company's investment in the instruments.

C. The findings of Commissions and Courts in other cases sustaining License Contract payments were rendered inapplicable to support any corresponding finding on the 1932 hearing, because:

(1) Findings of fair telephone instrument rental in other cases, when tested by the American Company's actual experience as revealed on the 1932 hearing, were grossly excessive. The yield therefrom ranged from 33% to 76% on the American Company's investment in the instruments involved.

(2) Appellee, on the 1932 hearing, disclaimed the service of Temporary Financing through loans by the American Company and the American Company's costs applicable thereto, as properly under the License Contract. But in twenty-three cases, Courts and Commissions relied on that service as the sole or principal reason to sustain the license payment. The District Court found on the 1932 hearing that holding funds by the American Company to effect the Temporary Financing and its costs incident thereto, were not properly under the License Contract and Appellee has not assigned error thereon. For other Associated Companies, including those involved in cases cited by Appellee as sustaining the license payment, the American Company's costs of Temporary Financing, including the holding of funds therefor, absorbed from 26% to 86% of the entire license payment made by them.

(3) On the 1932 hearing, evidence became available for the first time which showed that the American Company covered by the license payments its expenses to operate as a Holding Company investor in the securities of the Asso-

ciated Companies, and, as a Licensor for valuable considerations of inventions to manufacturers and others outside the telephone communication field and within the telephone communication field outside the Bell System.

III. The consideration that the American Company reduced the license payments from 4½% to 4% in 1926, to 2% in 1927, and to 1½% in 1929, does not prove that the license payments before or after each cut were fair, because:

A. From 1923 to 1925, inclusive, the license payment exceeded the amount necessary to pay expenses and reasonable return on investment applicable to License Contract, Holding Company, and Licensing of Inventions operations as found by the District Court, by $1,736,091. The reduction from 4½% to 4% in 1926 and 1927 involved an aggregate reduction in license payments of $478,306. As part of the consideration therefor, Appellee was required to pay the instrument taxes of $131,297 which theretofore the American Company paid, and Appellee paid in license payments for these two years $990,815 more than the District Court found properly applicable to License Contract operations.

B. The 1926 reduction merely eliminated from the license payment the portion thereof which the American Company had used prior thereto to provide the deficiency between the interest and dividends which it received on its investments in the Associated Companies and the interest and dividend requirements which it had on its own securities applicable to such investments. Such deficiency ranged from $1,500,000 to $4,500,000 per year. But the reduced license payment was admittedly contemplated to cover the expenses applicable to its Holding Company and

Licensing of Inventions operations in addition to its expenses properly applicable to License Contract operations.

C. The 1928 and 1929 reductions were not intended to refund to the Associated Companies any excess in the license payments over the amount necessary to cover the costs properly applicable to License Contract operations only. On the contrary, such reductions were less than those which should have been made as consideration for the additional values outside the License Contract received from the Associated Companies in connection therewith.

On December 31, 1927, the Associated Companies, including Appellee, were required to purchase from the American Company second-hand telephone instruments at a price which covered the American Company's cost, less 18.03% thereof, whereas, the American Company had already been reimbursed through the depreciation expense charges covered by rentals 48.9% of its cost. The American Company's profit on the sale aggregated $14,395,799, of which $726,540 was applicable to Appellee's Chicago intrastate business. By this sale, the American Company was relieved of the annual costs of owning and maintaining these instruments; was relieved of the obligation to supply, without additional charge, cradle telephone sets which had been developed and made commercially practicable by 1927, but which were much more expensive to own and to maintain than the desk stands; and was relieved of the greater charges against its depreciation reserve for retirement of desk stands resulting from the expected popularity of the cradle sets. By this sale, the American Company made it possible for Appellee to burden its telephone subscribers with a surcharge for the use of the cradle set to cover increased annual costs in their

use, instead of the American Company bearing that expense.

During the same period the superior investment position of the Bell System resulted in a lowering cost of funds to attract capital, but the American Company did not give the Associated Companies the benefit thereof in financing them under the License Contract. As a result, the American Company's return from the Associated Companies was sufficient to cover its own annual charges applicable to its investments in them, and to carry to surplus $40,165,520 for the period 1928 to 1930, inclusive.

Under these conditions the reduced license payments beginning with 1928 were even more unfair to the Associated Companies than those made prior thereto.

IV. Appellee's claim that the District Court erred in failing to include instrument, franchise, excise, capital stock and income taxes as costs under the License Contract is more than offset by other errors committed by the District Court in computing License Contract costs, and cannot be supported when viewed in the light of the facts in the record.

A. Appellee claimed that the District Court failed to allow as proper the instrument taxes for the years 1923 to 1925, inclusive, ranging from $42,000 to $65,000 per year. But Appellee failed to advise this Court that the District Court committed two other errors in its computations of fair rentals for the instruments, which errors inflated the rentals by amounts ranging from $95,000 to $116,000 per year. By reducing this inflation by the amount of instrument taxes which the District Court omitted, the inflation still ranges from $55,000 to $105,000 per year. On the basis of the District Court's findings, but after giving ef-

fect to the instrument taxes, omitted by it, the return to the American Company on its investment in telephone instruments ranged from 10.58% to 11.40% in the years 1923 to 1925, inclusive.

B. Appellee claimed that the District Court failed to allow as proper License Contract costs, the franchise, excise, and capital stock taxes of the American Company ranging from $30,000 to $72,000 per year. But Appellee failed to advise this Court that such amounts were computed on the basis of allocating to License Contract operations the taxes allocable to Holding Company operations. If the amount of such taxes were distributed between these two classes of operations, the amount chargeable to the License Contract operations would be negligible. As Appellee's portion would be less than 6% of such negligible amount, the District Court's error in not allocating to it any part of these costs was infinitesimal in effect.

C. Appellee claimed that the District Court failed to allow as proper License Contract costs, the Federal income taxes of the American Company ranging from $28,000 to $121,000 per year for the period 1923 to 1928, inclusive. But Appellee failed to advise this Court that it allocated the entire amount of Federal income tax to the License Contract operations. On the basis of such allocation, the American Company, as a Holding Company and as Licensor of Inventions, would have had taxable income only in 1927. The amounts properly chargeable to Appellee as part of the License Contract costs for the years 1923 to 1928, inclusive, which the District Court failed to allow, range from $4,000 to $79,000 per year.

APPELLEE'S CLAIMS COVERING FAIR RETURN (Infra, 55).

Appellee's Position.

Appellee seeks through its cross appeal to show that the District Court erred in its determination of the required minimum return for 1931 and 1932 to the substantial prejudice of Appellee, and that such prejudicial error was not offset by its corresponding determination for the previous years. In support of Appellee's position it urged:

I. The District Court should have applied the "attraction of capital and maintenance of credit" test of compensatory rates set forth in the *Bluefield* case in its determination of the required minimum return to avoid confiscation for the years 1931 and 1932.

II. Tested by the "attraction of capital and maintenance of credit" test, the District Court's findings of 6½% return for 1931 and 5½% return for 1932 are so arbitrary as to be void in that:

A. Returns which were less than 1% in excess of the annual charges on Appellee's bonds could not possibly provide also Appellee's dividend requirements on an 8% basis and the margin for surplus to which its stockholders are entitled.

B. On the basis of such returns Appellee could not possibly have attracted capital in 1931 and 1932. The District Court took judicial notice of the general decline of corporate earnings but failed to take judicial notice of the "greater and more notorious decline in the price of corporate securities."

III. The required minimum return found by the District Court for the years 1923 to 1930, inclusive, was in each case less than that shown by Appellee's witnesses to be proper, and less than that allowed in other cases sustained by this Court. Such findings therefore provide no cushion to offset the District Court's error for 1931 and 1932.

Appellants' Position.

I. Appellee's claim that the "attraction of capital and maintenance of credit" test of compensatory rates should have been applied for the years 1931 and 1932, is fatally defective in that:

A. The claim disregards the fact that Appellee had excess capital in 1931 and 1932. In July, 1930, Appellee sold to the American Company $8,000,000 stock in excess of its current needs, of which $4,729,440 is allocable to Chicago intrastate business; the proceeds of this sale remained on deposit with the American Company to 1932 and thereafter without being required by Appellee's business. Nor did Appellee include the interest accrued on such deposit in its showing of earnings available for return on such capitalization.

B. The claim involves the principle that Appellee is entitled to have applied the "comparative return" or "attraction of capital and maintenance of credit" test of compensatory rates, whichever is more favorable to it.

II. Appellee's claim that the required minimum return, as found by the District Court, is so arbitrary as to be void disregards its own experience and the undisputed facts in the record, in that:

A. Appellee's claim that a 6½% return in 1931 could not possibly provide the 8% dividend plus the required margin for surplus disregards the fact that the rate base value as found by the District Court, to which such return is applicable, exceeded the outstanding capitalization by $44,000,000. Related to such rate base a 6½% return would yield 11.15% return on outstanding stock and would provide the 8% dividend thereon plus $2,740,000 for surplus. On the basis of the 1931 capitalization, the 5½% return on the rate base value for 1932, as found by the District Court, would provide the 8% dividend requirements plus $260,000 for surplus. Such rate of return for 1931 and for 1932 would be increased in each case if the excess capitalization issued in 1930 not used or useful in the public service thereafter were eliminated or if the interest on the proceeds thereof were included as part of Appellee's earnings available for return. Appellee made no showing that during these depression years any other utility earned any such returns. Such returns are excessive if considered as the total return and more so when considered with the advantages of additional pecuniary profit and additional security which the American Company received from Appellee but which are not received by the ordinary investor outside the Bell System.

B. Appellee's claim that there was a notorious decline in the market price of corporate securities, in the years 1931 and 1932, disregards the following undisputed facts in the record:

(1) Appellee's claim has no application to Appellee's bonds. The yield on the resale price of Appellee's bonds in 1931 was 4.76%. The investor who purchased such bonds on the original public offering in 1923, or

in the open market in the years 1923 to 1926, inclusive, or even in the year 1929, could have resold his investment in 1931 at a substantial profit. Appellee's bonds in 1931 were rated AAA. The notorious decline in market prices had no application to AAA bonds. Similarly the market price of stocks behind AAA bonds was higher in 1931 than the corresponding market price of such stocks in the years 1923 to 1925, inclusive.

(2) The annual cost on AAA bonds of public utilities issued in 1931 was lower than the annual cost of AAA bonds of the same issuer offered in any of the years 1923 to 1930, inclusive.

(3) Appellee's claim that credit money was more difficult to obtain in 1931 than in prior years had no application to securities which, like Appellee's, enjoyed the highest investment rating. The percentage of total financing represented by the highest grade investment bonds in 1931 was 33%. Such percentage was greater than the corresponding percentage in any other year in the case of public utilities; and the amount in dollars of the highest grade investment bonds offered in 1931 represented more than 74% of the entire amount in dollars of all issues of the same rating offered in the period 1923 to 1930, inclusive.

Appellee's claim of the notorious decline in market price of corporate securities had application, if at all, to bonds of inferior investment rating than that enjoyed by its bonds and by Bell System bonds in 1931 and 1932; and had application, if at all, to stocks behind such inferior graded bonds.

III. Appellee's claim that the required minimum return for each of the years 1923 to 1930, inclusive, as found by

the District Court, was less than that which was shown proper by Appellee's witnesses and less than that allowed in other cases by this Court disregards the facts that:

A. The testimony of Appellee's witnesses consist of prognostications which are fatally defective because they are contrary to Appellee's actual experience and to the comparable experience of the other Associated Companies, and are based on five assumptions which are contrary to the facts of such actual experience.

B. The returns of other cases cited by Appellee as having been sustained by Courts have no application to the instant case. In some of those cases the discussion on return was academic; in others, there was not even a statement by the Court of any specified rate of return necessary to avoid confiscation; and in the balance of the cases the facts involved were opposite to those which the record shows for Appellee.

APPELLEE'S CLAIMS COVERING DEPRECIATION EXPENSE ALLOWANCES (Infra, 70).

Appellee's Position.

Appellee's claim is that the District Court's depreciation expense allowances, which represented a compromise between Appellee's and Appellants' claims, erred to its prejudice in that:

I. Appellee's judgment of the proper depreciation expense charges should have been followed by the District Court as a managerial act which had not been shown to be arbitrary or otherwise improper.

II. The District Court should not have given any consideration to the 1920 Order on depreciation expense allowances because it was temporary, was superseded by the 1923 Order; and covered "retirement" but not "depreciation" expense charges.

III. The District Court should not have given any consideration to the 1923 Order on depreciation expense allowances because:

A. In a confiscation case, the Commission's finding of fact is not competent evidence.

B. The language of the 1923 Order covered "retirement" and not "depreciation" expense charges.

C. The allowances by the 1923 Order were so grossly inadequate as to be void in that the aggregate of such allowances for the period 1923 to 1931, inclusive, barely covered the retirements of the same period.

Appellants' Position.

I. Appellee's right as a managerial act to originate the amount of depreciation expense charges and to make changes therein was taken away from it by Section 14 of the Illinois Public Utilities Act, and was placed in the Illinois Commerce Commission. Even if Appellee had such right, its showing thereon was fatally defective.

II. Appellee's objections to the 1920 Order are raised for the first time and represent a collateral attack on state action. For the reasons stated in Appellants' Brief, pages 388 to 392, they should be disregarded.

III. Appellee's objections to the 1923 Order on depreciation expense allowances are fatally defective because:

A. They disregard the evidentiary value attaching to a legislative act pursuant to Section 14 of the Illinois Commerce Commission law.

B. The Commission's Order made adequate findings for depreciation expense charges and was not limited to retirement expense, as shown by the facts that: (1) the excess of allowances over retirement charges in the period 1923 to 1927, aggregated $7,180,000; (2) despite the same attack on the form of the 1923 Order by Appellee before this Court in *Smith* v. *Illinois Bell Tel. Co.* (282 U. S. 133), this Court treated the 1923 Order in respect to the allowances as covering depreciation expense charges; (3) the entire discussion in the Commission's Order clearly shows its intent to make adequate depreciation expense allowances, and Appellee reads into the order of the Commission language which is not there and which is not warranted.

C. Appellee's claim that the allowances by the 1923 Order were so grossly inadequate as to be void, based upon the relation of the aggregate thereof for the period 1923 to 1931, inclusive, to the aggregate retirements for the same period of time, if considered as a single unit of time, disregards the facts that: (1) for the years 1923 to 1927, inclusive, the allowances exceeded the retirements by wide margin; (2) where depreciation expense charges are computed on the straight line method, the adequacy of the amount thereof in any one year cannot be measured by the retirements for the same year. Such retirements cover property installed in prior years—for the loss in service value of which property depreciation expense charges of prior years have been accumulated; (3) Appellee's comparison of the allowances with the retirements presents a distorted picture, because (a) it includes under retirements the loss on general equipment, for which reimbursement has already been provided in accounts other than in the depreciation expense account, ranging from $109,000 to $225,000 per year; (b) Appellee changed its depreciation accounting methods on exchange aerial wire beginning with 1929, the effect of which was to increase operating expenses thereafter by charges applicable to the depreciation reserve of $600,000. Such charges are a cushion to be added to the depreciation allowances beginning with 1929; (c) Appellee's retirements beginning with 1928 are excessive because of second-hand telephone instruments acquired at the end of 1927 on which the American Company had accrued a 48% depreciation reserve, but in respect to which only a 18.03 [redacted]% depreciation reserve was transferred on their sale to Appellee; (4) Appellee failed to give consideration to the fact that on account of the depression the factor of inade-

quacy covered by the depreciation expense charges and allowances prior to 1929-1930 was eliminated in respect to all property then in service to which such charges and allowances have application; (5) the relation of the net increase in depreciation reserve to the net increase in plant during the period of the allowances is without significance in the absence of a showing of the relation of the net increase plus the depreciation reserve already accumulated at the date of the allowances to the investment in service to which they have application. Appellee made no showing that such total reserve would be inadequate. On the contrary the facts of Appellee's experience by comparison with that of other Associated Companies shows such reserve to be adequate. Moreover the depression has released a large portion of the reserve accumulated (a) to provide against retirements of property in service because of inadequacy, and (b) to provide for anticipated depreciation on contemplated future additions to central offices and buildings.

APPELLEE'S CLAIMS COVERING DEPRECIATION IN VALUATION (Infra, 80).

Appellee's Position.

The District Court's finding on Depreciation in Valuation failed to follow the Minnesota Rate Cases which require that the deduction from rate base value new in arriving at the rate base should be only for depreciation revealed by inspection. The District Court deducted from $9,300,000 to $13,800,000 more than the amounts so revealed by Appellee's presentation.

Appellants' Position.

Appellee's position interprets the language of the Minnesota Rate Cases, "actual existing depreciation," to exclude foreseeable facts and contingencies causing property retirement which Appellee claimed are certain of realization in the service life of the property inspected but which are not manifest at the date of such inspection. Such narrow interpretation is contrary to the express language of the Minnesota Rate Cases, disregards the depreciation accounting practices to which the language quoted by Appellee from the Minnesota Rate Cases had application, and disregards its own accounting practices which determine what the proper deduction should be.

APPELLEE'S CLAIMS COVERING THE DISTRICT COURT'S CUT IN VALUATION IN 1930 AND THEREAFTER TO ELIMINATE THE EFFECT OF THE PRICE INCREASE BY WESTERN (Infra, 89).

Appellee's Position.

The District Court reduced the rate base value by more than $4,750,000 in each of the years 1930, 1931 and 1932 to eliminate the effect of Western's 10% Price Increase in 1930. Such reduction was improper because:

I. The price increase was justified as it merely corrected the price decrease of 1929 which was based on anticipated large volume of business in future years not realized.

II. Western's prices, even after the increase, were lower than those of other manufacturers.

III. Western's profits from Bell business done at the increased prices were not more than reasonable as found by the District Court.

IV. Western did not overreach the Bell System even after the increase in prices, as found by the District Court.

Appellants' Position.

Appellee's position is based on the same fundamental errors on which it based its presentation before the District Court on Western's Profits and Prices as the basis for the District Court's findings thereon. Appellee's position disregards the facts that:

I. The reproduction program assumed in Appellee's revaluation for each year would involve annual purchases from Western in volume greater than that upon which Western based its decrease in prices in 1929.

II. Western's price policy during the depression based on standard costs established prior to and during 1929 precludes comparison between its prices during the depression with those of other manufacturers.

III. Appellee's claim that Western's profits from Bell business during the depression were no more than reasonable assumes, contrary to fact, the proper separation of manufacturing facilities and expenses between Bell and non-Bell business, and the proper relation of Bell profits to profits from business with Appellee in the same years.

IV. Appellee's claim that Western did not overreach the Bell System through their relationship has no application to the issues involved in the use of Western's current prices to revalue Appellee's property.

THE DISTRICT COURT'S UNDERVALUATION IN 1931 AND 1932 (Infra, 95).

Appellee's Position.

The District Court should not have reduced the rate base value by $18,500,000 in 1931 and $23,000,000 in 1932 to give effect to reduced prices of labor and material. Appellee's reproduction cost new estimates for these years gave effect to its own expense and not to inflated value.

Appellants' Position.

I. Appellants construe the entire amount of the cut in valuation in 1931 and 1932 as intended by the District Court to eliminate the effect of the 1930 increase in Western's prices.

II. Assuming Appellee's construction is correct, its claim is fatally defective as it assumes, contrary to law, that its reproduction cost new estimates measure value.

DISCUSSION.

APPELLEE'S CLAIMS COVERING LICENSE CONTRACT SERVICES AND PAYMENTS.

I.

Appellee's Claim.

(Appellee's Brief, p. 80.)

"The District Court found that the American Company's costs of rendering Appellee's License Contract services in 1929 to 1931, inclusive, were $768,000 in excess of Appellee's license payments of such years. The District Court allowed as proper operating expense for such years only the license payments; it should have allowed the full amount of the American Company's costs.

Appellants' Answer.

The District Court inflated the American Company's costs of rendering Appellee's License Contract services in 1929 to 1931, inclusive, by $2,558,000, by including therein costs applicable to its Holding Company and Licensing of Inventions operations (Appellants' Brief, p. 86). By allowing as proper operating expenses only a portion of such costs, the District Court merely reduced the amount of inflation in Appellee's operating expenses. Appellants gave effect to such reductions in their showing of the proper amounts which should have been allowed by the District Court as proper operating expense to cover Li-

cense Contract services (Appellants' Brief, p. 86, Appendix to Appellants' Brief, p. 54).

Appellants direct attention, however, to the fact that the District Court's allowances for the years 1929 to 1931, inclusive, now complained of by Appellee, are the identical amounts which Appellee's requested findings asked the District Court to allow as proper operating expense (R. III, 2417). Similarly, the amounts of the American Company's costs as found by the District Court correspond to those requested by Appellee to be found (R. III, 2416). Appellee is complaining in this Court about its own requested findings.

II.

Appellee's Claim.

(Appellee's Brief, p. 89.)

Upon the first hearing in 1929, the District Court found that "the case for the allowance of the entire amount for services is a strong one." No facts appeared at the second trial in 1932, to warrant any change in that conclusion. The District Court, therefore, should have allowed the entire license payment as proper operating expense for each of the years 1923 to 1928, inclusive, upon the authority of other cases which allowed as proper the entire license payments.

Appellants' Answer.

This Court's direction of December 1, 1930, made available five separate classes of facts which precluded the Dis-

trict Court, on the 1932 hearing, from reaching the same conclusion which it reached at the former hearing in 1929, and from relying on other cases wherein the entire license payment was allowed as proper. These were:

1.

On the basis of the District Court's findings, Appellee's license payments of $9,176,000 for the years 1923 to 1927, inclusive, exceeded the American Company's costs applicable thereto, by amounts ranging from $433,000 to $631,000 per year, and aggregating for the period $2,727,000 (Appellants' Brief, p. 84) But the American Company's costs, so found, covered (a) the American Company's expenses found applicable to License Contract operations (Appendix to Appellants' Brief, p. 54); (b) more than a reasonable return on the American Company's investment found applicable to such operations (*infra*, 51); (c) expenses and return on investment applicable to the American Company's Holding Company and Licensing of Inventions operations (Appellants' Brief, pp. 174, 184); and (d) a portion of the appropriations to the Reserve for Contingencies (Appellants' Brief, p. 194).* The excess over such costs would increase the unjust enrichment of the American Company.

2.

On the 1929 hearing, the record showed that (a) the 1920 Order which fixed the telephone rates charged in 1923, had

*Although Appellee claimed that the appropriations to the Reserve for Contingencies were intended by the American Company to form a Patent Infringement Liability Reserve (Appellants' Brief, pp. 203, 207), the American Company's representations to Bankers who purchased its bonds showed the earnings covered by such appropriations as available for interest requirements (R. V, 3415, 3497; cf. R. V, 3307, 3312, 3318, 3323, 3331).

provided an allowance of $1.13 per station as reasonable rental for the use of telephone instruments in Chicago; (b) the 1923 Order, now under attack, made no change therein; and (c) Appellee estimated that its annual charges to provide and maintain the instruments in 1923, had it owned them, would have been $1.07 per station, or $681,994* (O.R. III, 1038). The District Court, without approving, accepted the Commission's ruling on the license payment of 1923 to be allowed as proper operating expense, for the purpose of determining the issue of confiscation for that year (*Smith* v. *Illinois Bell Tel. Co.*, 282 U. S. 133, at 155-6).

On the 1932 hearing, the actual experience of the American Company in 1923, in respect to these instruments, was made available to Appellants for the first time, pursuant to this Court's direction of December 1, 1930. Appellants showed that a rental of $1.13 per station in 1923 would be sufficient to cover maintenance, depreciation expense charges, and instrument taxes incurred, charged or paid by the American Company, and to yield to the American Company 45.79% on its investment in the instruments (book cost less the amount in depreciation reserve account) (O.R. III, 1038; R. IX, 4987). Appellants showed, also, that, on the same basis, a rental of $1.13 per station in 1920, when the 1920 Order was issued, would yield 51.28% on such investment (R. IX, 4991); that a rental of $1.07 per station in 1923 would yield 42.27% on such investment (R. IX, 4989).

Appellee's presentation on the 1932 hearing claimed that for 1923 a fair rental should be $415,482 (R. III, 2411), or 65c per station. Appellants showed that 65c per station would be sufficient to yield to the American

*$709,000 estimated in 1929, covered the Chicago Division. This figure is reduced in the text to the intrastate portion thereof to make it comparable to the 1932 showing.

Company 16.53% on investment after covering all maintenance, depreciation expense charges, instrument taxes actually incurred, charged or paid by it as shown on its books (R. IX, 4987).

On the 1932 hearing, the District Court allowed, as fair rental for 1923, $342,000, or 54c per station (R. III, 2510).* Such allowance was sufficient to cover maintenance, depreciation expense charges and instrument taxes actually incurred, charged or paid by the American Company as shown on its books, and to yield 9.43% return on investment (book cost less the amount in depreciation reserve account) (Appendix, *infra*, 99). On the basis of the District Court's allowance of depreciation expense charges, the yield was 11.40% on such investment (Appendix, *infra*, 99).

Comparison of the 1929 and 1932 evidence and findings shows for fair rental:

Commission's Allowance	Appellee's Claim 1929 Hearing	Appellee's Claim 1932 Hearing	District Court's Finding on 1932 Hearing
$718,393	$681,994	$415,482	$342,000

On the 1929 hearing, the District Court determined the issue of confiscation on the basis of the Commission's allowance covering License Contract services. Such allowance reduced, as proper operating expense for 1923, the amount of the license payment by $360,000 (O.R. I, 191). Such allowance applicable to intrastate business was $1,312,032.** On the 1932 hearing, the District Court found as the proper operating expense covering License Contract services, $1,088,195 (R. III, 2519), or $223,837 less than the amount used by it on the previous

*The District Court's errors in computing the rental are shown *infra*, 47.

**96.19% of $1,364,000 (Appendix, *infra*, 101; O.R. I, 191).

trial. As Appellee's 1932 claim covering telephone instrument rental for 1923 was less by $266,512 than its 1929 claim, the District Court's allowance on the 1932 hearing covering license payments as operating expense was more favorable to Appellee than the District Court's findings on the previous hearing!

3.

The direction of this Court of December 1, 1930, has made possible for the first time the comparison of findings by Courts and Commissions in other cases covering the fair rental of telephone instruments with the American Company's actual experience in respect thereto. Considering cases where the facts are available, such comparison shows that the findings therein were far out of line with the real facts (Appendix, *infra,* 103-4):

(a) For the year 1920, the allowance in the *Chesapeake & Potomac* cases yielded a return to the American Company ranging from 51% to 61% on its investment in telephone instruments (book cost less the amount of depreciation reserve account); the allowance in the *Southwestern Bell* case yielded a 69% return; and in the *Chicago Telephone* cases a 51% return. In the *Michigan Bell* case, relied on by Appellee, the presentation of fair rental covered by the allowance yielded the American Company a 76% return (Appendix, *infra,* 103).

(b) For the year 1921, the allowance in the *Indiana Bell* case, relied on by Appellee, yielded a 50% return (Appendix, *infra,* 103).

(c) For the year 1922, the allowance in the *Cumberland* case and *Indiana Bell* case yielded a 40% return (Appendix, *infra,* p. 7).

(d) For the year 1923, the allowance in the *New York Telephone* case, relied on by Appellee, yielded a 41% return (Appendix, *infra*, 104).

(e) For the year 1925 the allowance in the *New England* case yielded 33% (Appendix, *infra*, 104).

4.

On the 1932 hearing, Appellee claimed that no part of the $16,688,000 "net loss" to the American Company on Temporary Financing of the Associated Companies through loans to them for the period 1923 to 1931, inclusive, should be allocated to Appellee's operating expenses or covered by Appellee's License Contract payments (R. I, 1003; R. III, 2416-17). Such "net loss" was computed to be the difference between the interest received by the American Company from such loans and the annual interest and dividends paid to its investors on its own funds applicable to such loans (R. I, 972).

Mr. Heiss, Comptroller of the American Company, as Appellee's witness, testified further that although such "net loss" was charged as proper License Contract costs in other cases, if he were to now make the presentation in such cases over again he would not include therein any portion of such costs under the License Contract (R. I, 1003). And the reason for the change of position, he testified, was "as one grows older, one gives further consideration to things, and has the right to change his mind" (R. I, 975).* But in

*Mr. Heiss included the cost of Temporary Financing in his presentation in 1928 in the Michigan Telephone Case and in his presentation in 1931 in the Ohio Telephone Case (R. I, 975). The Associated Companies involved in those cases were heavy borrowers (R. VI, 4030, H and I); but Appellee's borrowings from the American Company were negligible (Idem.). Mr. Heiss changed his mind after his presentation in 1931 in the Ohio Telephone Case (R. I, 975). His excuse given in the text should

twenty-three cases Courts and Commissions relied on this service and its cost as the sole or principal reason for sustaining the entire license payment to the American Company.*

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be weighed with the consideration that Appellants' Brief on the Appeal in 1930, before this Court, laid stress on the fact that the other Associated Companies absorbed through the Temporary Financing service the whole or a large portion of their respective license payments (Appellants' Brief, Smith v. Illinois Bell Tel. Co., 282 U. S. 133, pp. 162-3, 185-6; 188-193; 243-4; 247-51).

In the Michigan Telephone Case, where the Associated Companies owed the American Company from $19,000,000 to $38,000,000 in 1927-8-9 (R. VI, 4030 H), Mr. Heiss showed for 1928 "a net loss" to the American Company in its Temporary Financing of the Associated Companies, of $4,100,000 (R. VI, 3770); in the instant case, where such service was negligible, the net loss for 1928 was presented by him as only $1,050,000 (R. IV, 2958). His excuse for the $3,000,000 discrepancy was that "At the time, in 1928, when I hadn't much experience in this matter, I was told in conjunction with our people to set up the money cost in the way that I described. Now that will make a difference of two or three million dollars. We had a method which I used in 1928, and I saw fit to change that method, after mature consideration, for these present cases" (R. I, 1002). Other instances of his opportunistic proclivities are given in Appellants' Brief, pp. 203, 206.

*Birmingham v. Southern Bell Tel. & Tel. Co. (Ala. P. S. C. 1918), P. U. R. 1919B, 791.
In re Rates, etc., of Telephone Companies (Arizona Corp. Comm. 1919), P. U. R. 1920B, 411, 462, 463, 464.
In re Southwest Bell Tel. Co. (Ark. Corp. Comm. 1920), P. U. R. 1921B, 516, 522.
In re Southern Cal. Tel. Co., No. 14420 (1924), 25 Cal. R. C. R. 721, 747.
In re Chesapeake & Potomac Tel. Co. (D. of C. P. U. C. 1920), P. U. R. 1920D, 614.
In re Mountain States Tel. & Tel. Co. (Idaho P. U. C.) P. U. R. 1921B, 739, 755-757.
Indiana Bell Tel. Co. v. Public Service Commission (1924), 300 Fed. 190 (D. Ind.) P. U. R. 1925A, 363.
Indiana Bell Tel. Co. (Ind. P. S. C. 1922), P. U. R. 1922E, 46, 63.
In re New England Tel. & Tel. Co. (Me. P. U. C. 1925), P. U. R. 1926B, 247, 258.
State ex rel. Hopkins v. Southwestern Bell Tel. Co. (1924), 115 Kans. 236, 223 Pac. 771, P. U. R. 1924D, 388, 413.
In re New England Tel. & Tel. Co. (N. H. P. S. C. 1926), P. U. R. 1926E, 186.
In re Chesapeake & Potomac Tel. Co. (Md. P. S. C. 1920), P. U. R. 1920F, 417, 437.
In re Chesapeake & Potomac Tel. Co. (Md. P. S. C. 1916), P. U. R. 1916C, 925.
In re Michigan State Tel. Co. (Mich. R. Comm. 1918), P. U. R. 1918C, 81.
Detroit v. Michigan Railroad Commission (1920), 177 N. W. 306, P. U. R. 1920D, 867, 878.

On the 1932 hearing, the District Court disallowed, as part of the License Contract costs or payments allocable to Appellee's operating expenses any part of the $23,000,000 "net loss" to the American Company of holding funds to meet the Temporary Financing of the Associated Companies. Such "net loss" was computed to be the difference between the earnings received by the American Company

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In re Mountain States Tel. & Tel. Co. (N. Mex. Corp. Comm. 1923), P. U. R. 1923B, 352.

In re New York Tel. Co. (N. Y. P. S. C. 1923), P. U. R. 1923B, 545, 559.

Public Utilities Commission v. New England Tel. & Tel. Co. (R. I. P. U. C. 1925), P. U. R. 1926C, 207, 253.

Houston v. Southwestern Bell Tel. Co. (1922), 259 U. S. 318.

In re New England Tel. & Tel. Co. (Vt. P. S. C. 1926), P. U. R. 1927C, 348.

In re Chesapeake & Potomac Tel. Co. (Va. Corp. Comm. 1920), P. U. R. 1920F, 49, 94.

In re Chesapeake & Potomac Tel. Co. (W. Va. P. S. C. 1920), P. U. R. 1921B, 97, 121.

In re Mountain States Tel. & Tel. Co. (Idaho P. U. C. 1921), P. U. R. 1921B, 739, 757.

In re Rates, etc., of Telephone Companies (Arizona Corp. Comm. 1919), P. U. R. 1920 B, 411, 462, 463, 464. The Commission stated:

"We have found that $2,600,000 have been advanced by the Bell Company, a discount of 10 per cent, amounting to $260,000, whereas the total rentals paid by the Mountain States Company from 1914 to 1918, inclusive, amounted to $102,843.35."

In re Chesapeake & Potomac Tel. Co. (D. of C. P. U. C. 1920), P. U. R. 1920D, 614. Here the special financing in aid of the subsidiary cost the American Company $1,200,000, in three years, which as the Commission points out, represents the license payment for a period of almost eight years.

In re New England Tel. & Tel. Co. (N. H. P. S. C. 1926), P. U. R. 1926E, 186. The opinion shows that although "the credit of the New England Company has been impaired during the last two years (1925-1926) yet it has been able to borrow all the money it needed," from the American Company, at the time of this case the figure being $40,869,000, on demand notes. "On January 1, 1925, the subsidiary (operating in all of New England states except Connecticut) owed the American Company $31,220,000 on demand notes and by July 1st of that year the figure had increased to $40,869,000."

In re Chesapeake & Potomac Tel. Co. (W. Va. P. S. C. 1920), P. U. R. 1921B, 97, 121:

"It is further shown that the applicant * * * has been financed by the American Company, either directly or through its subsidiaries to the extent of over $5,000,000, at an annual interest rate of 6 per cent, payable in arrears; and but for the financial assistance thus received, applicant's interest rate upon this money would exceed by at least 2 per cent the rate it has been required to pay."

on such funds pending their use for loans to the Associated Companies, and its own annual interest and dividends paid to its investors on such funds. Appellee claimed at the hearing that such "net loss" was properly allocable to License Contract (R. III, 2411). Such "net loss" was part of the American Company's License Contract costs as presented in other jurisdictions (R. I, 1002). Apparently, however, Appellee does not assign error to the District Court's finding against its claim and does not complain in this Court in respect thereto, although it does complain of its other findings on License Contract.

But the record shows that the cost to the American Company of Temporary Financing and of holding funds available therefor in the case of other Associated Companies absorbed a large portion of the license payments received from such other Associated Companies, including those involved in the cases cited by Appellee in support of its position that Appellee's entire license payment should have been allowed each year of the litigation. To illustrate:

These costs absorbed from 27% to 34% of the license payments of the years 1922 to 1926, inclusive, made by Pacific Telephone & Telegraph Company (R. VII, 4047, 4050e; *Pacific Tel. & Tel. Co.* v. *Whitcomb*, 12 Fed. (2d) 279 (1926)); from 20% to 26% of the license payments of Southern Bell Telephone Company for the years 1921 to 1923, inclusive (R. VII, 4047, 4050e; *Southern Bell Tel. & Tel. Co.* v. *Railroad Commission*, 5 Fed. (2d) 77 (1925)); from 26% to 32% of the license payments of Southwestern Bell Telephone Company for the years 1921 to 1923, inclusive (R. VII, 4048, 4050f; *Houston* v. *Southwestern Bell Tel. Co.*, 259 U. S. 318 (1922)); from 55% to 86% of the license payments of Indiana Bell Telephone Company for

the years 1921 to 1924, inclusive (R. VII, 4042, 4050b; *Indiana Bell Tel. Company* v. *Public Service Comm.*, 300 Fed. 190 (1924)); from 41% to 52% of the license payments of Michigan Bell Telephone Company for the years 1922 to 1924, inclusive; and from 51% to 78% of the license payments of the same company for the years 1926 to 1930, inclusive (R. VII, 4043, 4050b; *City of Detroit* v. *Michigan R. R. Commision*, 209 Mich. 395 (1920); *Michigan Public Utilities Comm.* v. *Michigan State Tel. Co.*, 228 Mich. 658 (1925)).

5.

On the 1932 hearing, the records of the American Company, made available for the first time by direction of this Court of December 1, 1930, disclosed that the License Contract operations as claimed in other cases and in the instant case covered (a) the American Company's financing and management operations as Holding Company investor in the securities of the Associated Companies (Appellants' Brief, pp. 184, 174); (b) the Development and Research work covering the development of patents and inventions to be used, for valuable consideration to the American Company, in the non-telephone field and in the telephone communication field outside the Bell System (Appellants' Brief, pp. 95-6); (c) appropriations to Reserve for Contingencies (Appellants' Brief, p. 194).

III.

Appellee's Claim.

(Brief, pp. 90-1; 14.)

In its actual operation, the License Contract yielded a substantial profit to the American Company in the years 1923 to 1928, inclusive, and a substantial loss in 1929 to 1931, inclusive. The American Company has sought to have the license payments kept fair, and for that purpose voluntarily reduced the rate of license payments from 4½% to 4% in 1926, to 2% in 1928, to 1½% in 1929. All of the reductions have been voluntary and without consideration to the American Company, except for the discontinuance of the furnishing of the instruments. All of the reductions were made after the 4½% rate had been sustained in cases in this Court and in other courts. Considering the results for the entire nine-year period, 1923 to 1931, inclusive, as a single unit of time, the license payments have been fair and should have been allowed for each year of that period.

Appellants' Answer.

Appellee misstates the facts and the law.

The consideration that the American Company reduced the license payments does not prove that such payments, before or after each cut, were fair, because:

1.

1926 Reduction.

The 1926 reduction was neither a charitable act on the part of the American Company, nor was it made without consideration, as claimed by Appellee.

For the three years 1923 to 1925, inclusive, Appellee's license payments exceeded by $1,736,101 the amounts found by the District Court as necessary to cover the American Company's expenses and return on investment applicable to License Contract, Holding Company and Licensing of Inventions operations (Appellants' Brief, p. 84). The reduction from the 4½% to the 4% rate resulted in a gross saving to Appellee of $230,696 in 1926, and of $247,610 in 1927 (Appellants' Brief, p. 84). But as part of the consideration therefor, Appellee was required to pay the instrument taxes which theretofore the American Company had paid (O.R. IV, 1216). Such taxes were $63,404 for 1926 and $67,803 for 1927 (R. IV, 2934, 2736-8 ratios; R. IX, 5018A). By such amounts, therefore, must the saving be reduced. But in 1926 and in 1927 the license payments still exceeded by $990,715 the allowances by the District Court, which allowances in turn were excessive (Appellants' Brief, p. 84). It is clear, therefore, that the 1926 reduction did not refund to Appellee any portion of the excess license payments of the previous years, nor did it serve to make fair the 1926 and 1927 license payments.

Appellants submit the following facts from the American Company's actual experience, as the explanation and significance of the 1926 reduction; and as conclusive proof that Appellee's claim in respect thereto is a figment of its imagination.

In 1921 the American Company increased the dividend rate on its own stock from 8% to 9% (O.R. VII, 2617). From 1921 to the end of 1925, the American Company did not receive in dividends and interest from the Associated Companies, other than Appellee, sufficient to cover its own annual cost of funds (interest, amortization, and dividend

requirements) applicable to its investment in them, even on the basis that all of its expenses applicable to its Holding Company operations as such investor were absorbed by their license contract payments. The deficit ranged from $1,526,829 to $4,583,881 per year.* During that period, therefore, their license payments, in addition to covering such Holding Company expenses, provided a substantial portion of the funds required to meet the American Company's annual interest and dividend requirements, and to carry to surplus the necessary margins in conformity with the American Company's policy towards its own investors (*Smith* v. *Illinois Bell Tel. Co.*, 282 U. S. 133, at 161, 151; R. VII, 4059-60A; R. VI, 4008A-G). Beginning with 1926, the interest and dividend receipts from the Associated Companies were sufficient not only to cover the American Company's annual costs applicable thereto, but to carry to surplus substantial margins. The amount carried to surplus in 1926 was $3,360,687 (R. VI, 4030R).

This change in the investment position of the American Company from 1921 to 1926 was due to three factors whose continued effect to maintain and improve such position was clearly established and assured by 1926. These were: (1) the complete elimination of non-dividend paying Associated Companies and the continued increase in the number of Associated Companies earning and paying high dividend rates** (*Public Utilities Comm.* v. *New England Tel. & Tel.*

*The yearly deficits were 1921, $3,859,489; 1922, $4,583,881; 1923, $3,316,226; 1924, $1,526,829; 1925, $1,840,664 (R. VI, 4030 M. R.).

**In 1921 no dividends were paid by three Associated Companies; 4% was paid by one, 6% by two, 7% by one, 7¼% by one, and 8% by seven companies. By 1926 every Associated Company was on a dividend paying basis: 4% was paid by one, 6% by three, 7% by one, 7¼% by one and 8% by thirteen companies (Appendix to Appellants' Brief, p. 136). The result of these changes was that in 1921 the American Company's dividends from Associated Companies represented 6.37% on its book investment in their stocks; in 1926 the return was 7.35% (R. VI, 4027).

Co., P. U. R. 1926C, 207 at 257-60; Re New England Tel. & Tel. Co., P. U. R. 1926B, 247 at 255); (2) the substantial decrease in the ratio of the American Company's credit security investments in the Associated Companies on which it was receiving a uniform 5.88% return to its higher yielding stock investments in them*; and (3) the definite decline in the American Company's own rate of annual charges (interest and dividend requirements).**

Under the circumstances the American Company in 1926 reduced the license payment to eliminate therefrom the portion thereof which theretofore it had used to supply a portion of the dividend and interest requirements applicable to its investment in the Associated Companies. Similarly, the American Company, in 1926, made its first reduction in long distance rates (R. V, 3317). The reduced license payments, however, continued to cover, as before, all of the American Company's expenses of operating its General Department business (excluding Long Lines) covering License Contract operations, Holding Company operations and Licensing of Inventions operations (R. VII, 4090C-E). It was on such basis that the American Company's annual report to its stockholders in 1926, quoted by this Court in its Opinion of December 1,

*The American Company's stock investment in the Associated Companies increased from 73.8% in 1921 to 85.4% in 1926 of its combined stock and loan investment (R. VI, 4033). In 1921 its stock investment was $539,000,000 (R. VI, 4027) and loans $191,000,000 (R. VI, 4030F); in 1926 its stock investment had increased to $1,126,000,000 (R. VI, 4027), but its loans averaged only $192,000,000 (R. VI, 4030H). The American Company itself controlled this factor. The return to the American Company on its combined investment in 1921 was 6.16% and in 1926 7.11% (R. VI, 4030S, T).

**The American Company's rate of annual charges were (R. VI, 4010-5):

1921	6.68%	1924	6.85%
1922	6.90	1925	6.93
1923	6.87	1926	6.83

1930, stated that "the purpose of these contracts is not to make money for the American Company . . . . The revenue of $29,850,303 received under the contracts during 1926 only slightly more than offsets the estimated cost of over $29,250,000" (*Smith* v. *Illinois Bell Tel. Co.*, 282 U. S. 133 at 156). Such costs correspond to those presented for that year by the American Company at the 1932 hearing (R. IV, 2955). Such costs cover, in addition to the items found by the District Court to be within the License Contract, also the items admitted by Appellee, or found by the District Court, or claimed by Appellants as not properly within its scope—*i. e.*, net loss of Temporary Financing (*supra*, 32); of Holding Funds therefor (*supra*, 35); corporation, franchise, excise and income taxes (*infra*, 52, 54); expenses of direct distribution of the American Company's new issues of securities and of servicing outstanding securities (Appellants' Brief, p. 174); the expenses of operation of ten departments and of Development and Research applicable to its Holding Company and Licensing of Inventions operations (Appellants' Brief, pp. 184, 95); Appropriations to Reserve for Contingencies (Appellants' Brief, p. 194).

Appellee's claim covering the 1926 reduction bears no relation to the realities of the situation.

2.

1928 and 1929 Reductions.

Appellee's claim that the reduction from 4% to 2% in 1928 was in consideration of the discontinuance of furnishing the telephone instruments, states a half-truth and presents a distorted picture of that transaction. It fails to give effect to the profit and advantages which the American Company derived from the sale of the telephone instru-

ments and from the failure to give to the Associated Companies the benefit of the low cost of new money resulting from the superior investment position of the Bell System. The facts are:

The rental arrangement for telephone instruments as part of the License Contract was maintained from 1879 to 1927 because of three considerations (a) the obligations of the Western Union Contract to 1896 (Appellants' Brief, p. 98); (b) the necessity for the control by the American Company of the development of the instruments to insure satisfactory transmission, both local and toll, as an effective means of meeting competition during the period 1896 to 1908, when the telephone field was competitive (O.R. VII, 2395 (8), 2417 (5, 6), 2418 (9, 10); and (c) with the extension of public utility regulation beginning with 1908, the license payment came under close scrutiny (*San Jose* v. *Pacific Tel. & Tel. Co.*, Calif. R. R. Comm. Dec. No. 1008, Oct. 9, 1914; General Investigation of Telephone Rates in Vermont, Vt. P.S. Comm. No. 340, March 14, 1914; Re Southwestern Tel. & Tel. Co., Mo. P. S. C. P. U. R. 1915E, 1087); therein the American Company derived a distinct advantage through the rental arrangement in sustaining the license payment to cover rental plus other services. Such advantage came from the fact that beginning with 1908 Western sold telephone instruments in the open market at a higher price than the special price paid by the American Company (R. V, 3562). By using the higher prices as a basis to compute the annual charges which the Associated Companies would have to assume if they owned the instruments, it was possible to make a more favorable showing for the license payment, particularly after the War, which helped to sustain the entire payment (*Birming-*

ham v. *Southern Bell Tel. & Tel.*, P. U. R. 1919B, 791; Re Pacific Tel. & Tel. Co., P. U. R. 1919D, 345; *Buck* v. *New York Tel. Co.*, P. U. R. 1921F, *supra*, 31).

By 1928 two considerations required that the rental arrangement be discontinued:

(a) By the end of 1927 the American Company had definitely lost the advantage of using the higher open market prices of telephone instruments to inflate the fair rental charges because:

(1) Western had transferred its non-Bell retail sales to Graybar in 1926 and had itself withdrawn from the field of retail sales (Appellants' Brief, p. 121).

(2) Courts and Commissions were insisting that proof of the reasonableness of the license payments be predicated upon the facts of the American Company's actual experience and not upon the assumed experience which the Associated Companies had theretofore used and which had been sustained (*Re Chesapeake & Potomac Tel. Co.*, P. U. R. 1926E, 481 at 601-2 (1926); *Re New England Tel. & Tel. Co.*, P. U. R. 1926E, 186, at 196-9 (1926); *Re Rates Wisconsin Tel. Co.*, P. U. R. 1927A, 581 at 591 (1926); *Chesapeake & Potomac Telephone Co.* v. *Whitman*, 3 Fed. (2d) 938, at 957-8 (1925); *Chesapeake & Potomac Tel. Co.* v. *Commonwealth*, 147 Va. 43 at 78-9 (1927)).

(3) Western's price-reducing policy foreshadowed the risk that the current prices of the telephone instruments would be less than the book cost thereof, representing the American Company's investment therein (R. VI, 3762A-D); R. VIII, 4941-2.

(b) Between 1924 and 1927 the cradle set had been developed to a point where its use was commercially prac-

ticable. At least nine independent telephone companies were using telephone instruments of the cradle set type and were receiving from various Commissions authorizations to make a special surcharge for their use.* In the case of the Bell System, however, it was difficult for the Associated Companies to justify such a surcharge—such companies not being the owner of the instruments and not being able to show that they could not obtain from the American Company the new types of instruments under the License Contract without additional charge.

For the American Company to continue the rental arrangement of telephone instruments involved probable substantial losses in two respects:

(1) The original cost of cradle sets was higher (R. VI, 3762D) and the estimated depreciation and maintenance charges were higher than were those of the desk sets. (Re Proposed Rates for Handsets, 7 Ill. C. C. Rep. 607 at 609 (1928); *Re Wisconsin Telephone Company*, Wis. R. R. Comm. Order, February 23, 1928.)

(2) The expected popularity of the cradle sets presaged substantial retirements of the older type of telephone instruments, with resultant charges against the 48.9% depreciation reserve which the American Company had accumulated for this account. Indeed Appellee's position before the Illinois Commerce Commission on its petition for

*Re Kewanee Home Tel. Co.—Ill. Co. Comm. Order, Oct. 11, 1922; Re Reedley Tel. Co.—Calif. R. R. Comm., Order Sept. 19, 1923; Re Mitchell Tel. Co.—Ind. P. S. C., Order April 30, 1924; Re Twin City Tel. Co.—Wis. R. R. Comm., Order June 20, 1924; Re Union City Tel. Co.—Ind. P. S. Comm., Order Aug. 21, 1925; Pet. of Roselawn Tel. Exch.—Ind. P. S. Comm., Order Aug. 21, 1925; Pet. of United Tel. Co.—Kan. P. S. Comm., Order June 8, 1926; Re So. Ind. Tel. Co.—Ind. P. S. Comm., Order Sept. 17, 1926; Re Manteca Tel. Co.—Cal. R. R. Comm., Order Nov. 29 1926.

authorization to establish a surcharge was based, in part, on the contention that:—

> "if no additional charge be made for this particular class of instrument the result would be that a large number of subscribers would immediately request the installation of the telephone handsets and as a result the present apparatus of the company which is still serviceable would be rendered useless" (Re Proposed Charge for Handsets, 7 Ill. C. C. R. 607, at 608 (1928)).

Under these circumstances the advantage was clearly in favor of transferring the ownership of the instruments to the Associated Companies, thereby placing upon them the burden of protecting themselves by justifying the surcharge before the commissions, and enabling them to make a showing on the basis of ownership. In such showing they were successful (Re Proposed Rates for Handsets, 7 Ill. C. C. Rep. 607 (1928); Re Wisconsin Tel. Co., Wis. R. R. Comm. Order, February 23, 1928.)

On December 31, 1927, the Associated Companies were required to purchase from the American Company the second-hand telephone instruments theretofore leased to them at a price which covered the American Company's cost thereof less 18.03% of cost (R. VI, 4024), whereas the American Company had already been reimbursed through the depreciation expense charges covered by rentals, 48.9% thereof (R. VI, 4024). The profit to the American Company from such sale was $14,395,799, of which over $726,540 was applicable to the telephone instruments used in the Chicago intrastate telephone business (Appellants' Brief, pp. 231-2). Such profit offsets the total difference between the District Court allowance and the license payments actually made for the years 1928 to 1931, inclusive (Appellants' Brief, p. 85).

Without consideration of the profit to the American Company on the sale of the instruments and the burden on the telephone subscribers resulting therefrom, the picture of the 1928 reduction is distorted.

Such distortion is produced also by Appellee's failure to point out the following facts:

The three factors already mentioned (*supra*, 39) which had eliminated by 1926 the deficiency in the returns from the Associated Companies to meet the American Company's annual charges on its investment in them, operated with accelerated force during the period beginning with 1928 to the advantage of the American Company. As a result of the vigorous operation of these factors* during this period, the American Company received from the Associated Companies beginning with 1928 in interest and dividends sufficient to cover its own annual charges applicable thereto, and to carry to surplus $12,129,360, $12,037,809 and $15,998,351, respectively, for the years 1928 to 1930, inclusive** (R. VI, 4030R).

The considerations involved in the sale of the telephone instruments, together with the failure of the American Company to give to the Associated Companies the benefits

*In 1928 every Associated Company was on a dividend paying basis; 6% was paid by one; 7% by three; 8% by fifteen, and 9% by one. In 1929 no dividends were paid by one Associated Company; 6% was paid by one; 7% by two; 8% by sixteen, and 9% by one. In 1930 every Associated Company was again on a dividend paying basis; 4% was paid by one; 5% by one; 6¼% by one; 7% by one; 8% by sixteen, and 9% by one (Appendix to Appellants' Brief, p. 136). The American Company's dividends from Associated Companies represented 7.39%, 7.48%, 7.48% and 7.26%, respectively, on its book investment in their stocks during the years 1927 to 1930, inclusive (R. VI 4027). The American Company's stock investment in the Associated Companies increased from 73.8% in 1921 and 85.4% in 1926 to 89.3% in 1928 and to 86.4% in 1930 of its total investments in such years (R. VI, 4033). The American Company's annual charges (dividend and interest requirements) were in 1928, 6.55%, in 1929, 6.53%, and in 1930, 6.25% (R. VI, 4017-9).

**Figures for 1931 unavailable.

arising from the superior investment position of the Bell System, for which they were as much responsible as the American Company itself, more than justified the reductions in the license payments in 1928 and 1929. It made three reductions in the long distance rates during the same period (R. V, 3317; O.R. VII, 2680; R. V, 3328).

IV.

Appellee's Claims on Taxes.

(Appellee's Brief, p. 82.)

The District Court's findings of the fair share of the American Company's costs allocable to Appellee's Chicago intrastate business, should have included therein the instrument, franchise, excise, capital stock and federal income taxes of the American Company, which it failed to include.

A.

Appellee's Claim Covering Instrument Taxes.

(Appellee's Brief, p. 84)

The District Court's allowance for fair rental of telephone instruments for each of the years 1923 to 1925 failed to cover taxes on instruments paid by Appellee and reimbursed by the American Company in amounts ranging from $42,000 to $65,000 per year.

Appellants' Answer.

Appellee failed to advise this Court that the District Court not only erred in this respect, but committed other

errors in its computations of fair rental, which errors were all in favor of inflating the rentals by amounts far in excess of the taxes omitted by the District Court and complained of by Appellee. The District Court allowed as a fair return 6% on the current cost of new telephone instruments less 8% deduction for depreciation in valuation. The District Court's allowances erred in three respects, and were inflated thereby from $95,000 to $116,000 per year.

(1) Depreciation in Valuation.

The depreciation in valuation deduction was erroneous.

The American Company used the straight line method of computing depreciation expense charges on telephone instruments (R. I, 936). The depreciation reserve accumulated therefrom represented more than 47% of the book cost of instruments in service during the period 1923 to 1927, inclusive (Appendix, *infra,* 101). By adjusting the reserve to give effect to the District Court's allowance of 6% as a proper depreciation expense charge, instead of 7% as charged by the American Company, the reserve would still represent more than 43% of such book cost (Appendix, *infra,* 101). On the basis that the fair value new is measured by the *current cost* of telephone instruments, the percentage thereof which should have been deducted in arriving at the base on which a return should be computed was 43% and not 8% (Appellants' Brief, p. 361). The inflation of the allowance (based on a six per cent return) by this error alone ranged from $57,000 to $67,000 per year (Appendix, *infra,* 101).

(2) CURRENT COST AS RATE BASE NEW.

The District Court should have valued the instruments new at book cost. The current cost of telephone instruments used by the District Court to measure fair value new exceeded the corresponding book cost thereof by at least $383,692, or over 14% (Appendix, *infra,* 102). Such instruments were purchased from Western under a special arrangement (Appellants' Brief, p. 100). The per cent return to Western from its instrument business done on the current prices of 1923 to 1927, inclusive, compares as follows with that derived from Bell business as found by the District Court both related to the applicable undepreciated rate base as determined by the District Court:

	Instrument Business (R. VI, 3817; R. VIII, 4632A)	Bell Business (Appendix to Appellants' Brief, p. 84)
1923	11.3%	4.8%
1924	14.2	6.9
1925	8.5	10.2
1926	13.6	8.3
1927	10.6	10.4

As the per cent return to Western from Bell business was exorbitant for the years 1923 to 1927, inclusive (Appellants' Brief, p. 304), the per cent return from current sales of telephone instruments was clearly excessive—and to that extent are the District Court's findings on depreciation expense applicable to instruments and on fair return on investment thereon excessive.

That Western's current prices in any one year cannot be used to convert book costs of purchases into fair value new thereof, is clear from the discussion of Rate Base Value

in Appellants' Brief (Appellants' Brief, pp. 343-7). The inflation of the rental through the use of fair value based on current cost instead of on book cost ranged from $23,000 to $32,000 per year (Appendix, *infra*, 102).

(3) Return.

The District Court found that the American Company "is entitled to . . . . an annual return of 6% of the reasonable value of" the instruments. The dollar return allowed by the Court ranged from $158,000 to $197,000 in the years 1923 to 1927 (Appendix to Appellants' Brief, p. 54). However, this dollar return was much more than 6% when related to the fair value of the instruments as claimed by Appellee, as follows (Appendix, *infra*, 101):

	Return Allowed by District Court	Six per cent return	Excess of Court's allowance over 6%
1923	$158,069	$133,215	$24,854
1924	183,964	151,960	32,004
1925	197,531	164,836	32,695
1926	196,775	170,714	26,061
1927	177,148	169,782	7,366

The District Court's error arose from its use of Appellee's requested finding Number 42 (R. III, 2411). Such finding combined maintenance costs; 7% reproduction cost new of the instruments; and an 8% return related to the same reproduction cost new less 8% existing depreciation. From this combined request the Court attempted to eliminate maintenance and depreciation expense charges in order to determine the amount claimed as return. The Court deducted the actual maintenance (R. III, 2408) and the depreciation expense charges related to book cost (R. III, 2409) and assumed that the remainder represented Appel-

lee's claim of an 8% return. Since the Court intended to allow a 6% return, it determined its dollar figure of return by taking 75% of this remainder. In fact, such remainder represented not only Appellee's claim for return but also included the difference between Appellee's claim for depreciation expense charges related to reproduction cost new and the depreciation expense charges as charged on the American Company's books. The actual rate of return thus allowed by the District Court ranged from 6.26% to 7.26% (Appendix, *infra*, 105).

The total inflation of rentals through the District Court's errors ranged from $86,000 to $116,000 per year (Appendix, *infra*, 102). By reducing the inflation by the amount of taxes which the District Court omitted, the inflation still ranges from $55,000 to $105,000 per year (Appendix, *infra*, 102).

On the basis of the District Court's findings, the return to the American Company on its investment (book cost less the amount of depreciation reserve account) in instruments leased to Appellee was (Appendix, *infra*, 99):

1923	15.27%
1924	13.56
1925	15.12
1926	13.73
1927	12.58

Giving effect to the instrument taxes omitted by the District Court, the adjusted return to the American Company would still be excessive, as follows (Appendix, *infra*, 99):

1923	11.40%
1924	11.26
1925	10.58
1926	13.62
1927	12.58

B.

Appellee's Claim Covering Franchise, Excise and Capital Stock Taxes.

(Appellee's Brief, p. 86)

The American Company paid each year New York Excise and Franchise taxes, federal capital stock tax (to June 30, 1926) and stamp and miscellaneous taxes. The District Court found that such taxes were not covered by the License Contract and disallowed them as part of the costs thereof. The District Court stated the amounts allocable to Appellee if the taxes paid "were distributed in accordance with the percentages on which the actual costs to the American Company of its twelve departments were distributed" (R. III, 2511). Such amounts were those requested by Appellee to be found (R. III, 2413), and ranged from $30,100 to $71,800 per year (Appendix, *infra*, 105).

Appellee claimed that the taxes should have been allowed as the American Company could not have carried on its business as a corporation and performed the License Contract services if it had no corporate existence. A fair proportion of this tax was obviously a cost of furnishing services to Appellee under the License Contract.

Appellants' Answer.

Appellee failed to advise this Court that it allocated to the American Company's License Contract operations more than 86% each year of the aggregate of these taxes applicable to the American Company's total operations, ex-

cluding Long Lines, and less than 7% to the American Company's operations as a Holding Company investor in the Associated and other companies, and as a Licensor of Inventions (R. IV, 2933-7). Although the American Company owned stocks ranging from $756,463,932 (R. V, 3307) to $1,939,270,421 (R. VIII, 4424) per year, and other securities from $178,147,274 (R. V, 3307) to $316,577,487 (R. VIII, 4424) per year; received dividends and interest payments and royalties ranging from $67,000,000 to $178,000,000 per year (R. VI, 4008D-M); distributed interest and dividends ranging from $77,000,000 to $195,000,000 per year (R. VI, 4008D-M), the total of taxes allocated to it as a Holding Company ranged from $29,000 to $130,000 per year (R. IV, 2933-7). But the License Contract operations were charged with taxes ranging from $518,000 to $1,190,000 per year (R. IV, 2933-7), although the investment in telephone instruments ranged from $16,300,000 to $22,400,000 and the other assets applicable to License Contract operations at no time exceeded $15,500,000 (Appellants' Brief, pp. 174-5); the revenues ranged from $14,455,000 (R. VIII, 4799) to $32,454,000 (O.R. VI, 2292) per year, and the expenses from $23,000,000 to $35,200,000 per year (R. III, 2415). Of these expenses, from $1,300,000 to $6,300,000 per year in the period 1925 to 1931, inclusive, were incurred by Bell Telephone Laboratories, Inc., a separate corporation (R. IV, 2844S-W).

Obviously Appellee charged the License Contract operations with the expense allocable to Holding Company operations. The expenses of ten of the twelve departments were so allocated (Appellants' Brief, p. 184). Distributing the taxes between the Holding Company and License Contract operations would leave the portion allocable to

the American Company's License Contract operations negligible. As Appellee's portion would be less than 6% of such negligible amount, the District Court's error in not allocating any part of these costs was so small in effect as not to be worthy of consideration herein.

C.

Appellee's Claim Covering Federal Income Tax.

(Appellee's Brief, p. 85)

The District Court did not allow as part of the License Contract costs any federal income tax on the profits claimed by the American Company on the License Contract. Such tax is clearly chargeable. The amounts thereof ranged from $102,000 to $121,000 for the years 1923 to 1927, inclusive, $28,000 in 1928 and $7,000 in 1931.

Appellants' Answer.

Appellants concede that Appellee is chargeable with the federal income tax on the difference between the license payment and the costs allocable thereto as found by the District Court. Appellee would be required to make such payment if the difference were refunded to Appellee. The tax so computed would be (Appellants' Brief, p. 84; Appellee's Brief, p. 86):

	Excess of Payments over District Court Allowance.	Income Tax	
		Rate.	Amount.
[illegible]	$573,819	12.5%	$71,727
1924	631,049	12.5	78,881
1925	531,223	13	69,060
1926	432,704	13.5	58,415
1927	558,011	13.5	75,331
1928	31,553	12	3,786

Such amounts are, however, offset by the inflation in the telephone instrument rental above stated (*supra*, 48, 51).

Such amounts, however, are but a portion of the amounts claimed proper by Appellee and the District Court. On the basis of their allocation, the American Company as a Holding Company and Licensor of Inventions, had taxable income for only one year—1927—of the entire period 1923 to 1931, inclusive (R. IV, 2933-7).

APPELLEE'S CLAIMS COVERING FAIR RETURN.

I.

Appellee's Claim.

(Appellee's Brief, p. 106)

The District Court applied the "comparative return" test of compensatory rates. By so doing it gave no consideration to the factors which should be considered, as contemplated by the "attraction of capital and maintenance of credit" test set forth in the *Bluefield* case.

Appellants' Answers.

A.

Appellee's claim disregards the fact that it financed itself in 1930 admittedly in excess of its current capital requirements; such over-financing carried through the years 1931 and 1932 and made any further financing unnecessary.

In 1928 Appellee adopted a program of financing its estimated requirements for 1929 and 1930. It offered to its stockholders the right to subscribe for $40,000,000 par value of stock, half to be paid in 1929, 25% in January 1930, and 25% in July, 1930.

In January, 1930, the American Company paid its 25% subscription by cancelling $2,200,000 owing from Appellee to it and by crediting as a loan from Appellee $7,725,825 (R. I, 963; R. VIII, 4786). On the loan Appellee received 5.88%; on its stock Appellee paid 8% (R. VIII, 4461). No part of this loan was drawn down till May, 1930, and on July 1, 1930, the American Company still owed Appellee on account thereof $2,300,000 (R. VIII, 4786).

By July, 1930, it was apparent that the depression rendered the balance of the financing unnecessary (R. I, 1041). Nevertheless such financing was not deferred because, as Mr. Heiss, Comptroller of the American Company, testified, it would have been bad business for Appellee to have asked the American Company to defer the issue of stock; a corporation is presumed to go through with an offer of stock which it made to its stockholders (R. I, 1041). And this even though the License Contract provided that Appellee shall have the right to demand from the American Company "financial support and assistance in the premises as will tend to serve the best interests of both companies" (R. I, 963).

On July 1, 1930, the American Company again paid for its stock subscription by crediting $7,946,360 as a loan, no part of which was drawn down by December 31, 1930 (R. VIII, 4787). On the contrary, the American Company owed Appellee on that day $9,172,000 (Idem.). During 1931 Appellee deposited with the American Company additional

surplus funds so that by March, 1931, the American Company owed Appellee over $15,000,000. On December 30, 1931, there was still owing to Appellee $9,272,000, or more than the amount of the July 1, 1930 subscription credited as a loan on the books of the American Company. On December 31, 1931, the loan was reduced to $6,272,000, which amount was carried over to 1932 (R. VIII, 4789). How much of such loan was drawn down in 1932 or whether it was increased as in 1931, the record does not show*. But the record does show that the interest on such loan was not considered as part of Appellee's earnings in determining its return (R. II, 1260; R. IV, 2742).

From these facts it is clear that Appellee's claim based on any necessity to attract capital is absurd. That it should require the application of a test of compensatory rates which has no relation to the realities of its situation (*Kankakee Water Company* v. *Gilbert* (decided January 6, 1933, District Court, Northern District of Illinois, not yet reported, quoted *in extenso*, Appendix, *infra*, 110)), is consistent with its claims on License Contract (*supra*, 26) and on Depreciation in Valuation (*infra*, 80).

B.

For the period 1923 to 1930, inclusive, Appellee's claim for a compensatory rate is not predicated on the "attraction of capital" test, but on the "comparative return" test (Appellants' Brief, p. 451). On the attraction of

*According to Moody's, no new stock or bonds were issued in 1932. That the loans would be increased is to be expected from the consideration that on account of the depression the current depreciation expense moneys which are intended to provide for future retirement losses will not be used for additions in conformity with Appellee's policy (O.R. I, 27; R. II, 1191).

capital test, the District Court's findings of required minimum return are fantastic (Appellants' Brief, p. 499); the recorded return and the return from the attacked rates are clearly compensatory. Appellee's claim on Fair Return depends on the principle that it is entitled to have applied the comparative return, or the attraction of capital test of compensatory rates, whichever is more favorable to it!

II.

A.

Appellee's Claim.

(Brief, p. 107)

"It is impossible for us to see" how the 6½% and 5½% returns will provide the return to stockholders and the margin for surplus to which they are entitled for 1931 and 1932 as such return in each case is less than 1% in excess of Appellee's interest and amortization charges on outstanding bonds.

Appellants' Answer.

The vacuity of Appellee's claim arises from its disregard of its own experience and of the relation of the rate base value as found by the District Court to its outstanding capitalization. Such experience shows that for 1931 a 6½% return on the rate base value found by the District Court would enable Appellee to pay interest and amortization on money borrowed, and to pay cash dividends of 8% upon its capital stock allocable to its Chicago

intrastate business, and to carry to surplus $2,740,000 (Appellants' Brief, 503). Such margin is 39% in excess of its dividend requirements. Such a return would yield to Appellee's stockholders 11.15% on its outstanding capital stock, and 9.65% on its outstanding capital and surplus for 1931 (*Idem*, 502).

True it is, as Appellee pointed out, that the 6½% return is less than 1% in excess of Appellee's annual charges on its bonds (5.53%). But it is equally true, as Appellee *did not* point out, that the rate base to which the 6½% return is applied, as found by the District Court, exceeds by $44,000,000 Appellee's outstanding stock and surplus, and by $58,000,000 Appellee's outstanding stock* after deducting in each case the portion of the rate base value applicable to Appellee's outstanding funded debt (Appendix, *infra*, 106). 6½% on capital and surplus provides 7.51% on outstanding stock; 6½% on the excess of Appellants' rate base value over capitalization (Appendix, *infra*, 108) provides 1.78% on outstanding stock; 6½% on the additional rate base value arising from reproduction and going values allowed by the District Court above Appellants' contentions, and from its failure to make the proper deduction for depreciation in valuation, adds 1.52% to such return; 6½% on the rate base value applicable to funded debt provides the 5.53% return on the funded debt plus a margin available for the stock equal to .34% thereon (Appendix, *infra*, 107). Because of these facts does a 6½% return provide the 8% cash dividend on stock and 3.15% margin for surplus.

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*The issue of Appellee's securities for additions and betterments has been subject to state commission regulation since January 1, 1914 (Laws of Illinois, 1913, pp. 459, 470-1). From that date to December 31, 1931, the total funds obtained from the issue of securities were covered in each year by recorded investment in fixed capital, after allowing for plant acquired from surplus and reserve funds (R. VII, 4228A-B).

The vacuity of Appellee's claim is significant in view of the fact that its recorded rate of return under the existing rates was 4.81% for 1931 before giving effect to the District Court's disallowance of $1,204,000 maintenance and depreciation expense charges, and was 5.5% after giving effect thereto, as found by the District Court (Appendix to Appellants' Brief, pp. 118, 128). From the 4.81% Appellee earned all but $275,894 of its $6,963,000 dividend requirements to pay an 8% dividend; from the 5.50% Appellee would have earned such full dividend requirements and would have carried to surplus $929,000 in addition thereto. But such return in each case would have been increased by at least $300,000, had Appellee included as part of its net income the interest received from the American Company on the proceeds of the excess amount of capital stock sold in 1930 (*supra*, 57). Had Appellants excluded such excess capitalization as not being used or useful in the public service, as it did not include the interest earnings therefrom, the dividends would have been earned in each case and substantial surplus accumulations would have been provided.

Appellants direct the attention of this Court to the fact that in their Brief on Appeal they showed the returns to Appellee from the recorded income, from the attacked rates, and the required minimum return as found by the District Court in each case on the basis of the outstanding capitalization in 1930, 1931 and 1932, without giving effect to the earnings on the excess capitalization. (Appellants' Brief, pp. 456, 479, 482, 485, 492, 494, 495, 502). To that extent is such return in each case understated in the discussions therein.

On the assumption that Appellee had the same capitalization in 1932 as in 1931 the 5½% return related to the rate

base value found by the District Court would have enabled Appellee to pay an 8% dividend from current earnings and to add to surplus $260,000 (Appendix, *infra,* 107). Such return would have been increased by the amount of the interest on the funds derived from the excess capitalization which Appellee received but which are not included in its showings on return. Such a return would have exceeded the estimated recorded return by $2,354,000; but Appellee's credit securities in 1932 retained their comparative superior stability in relation to credit securities of other companies (Appellants' Brief, p. 486). Appellee made no showing that any other utility earned more than 8% in 1931 and 1932, or that such earnings were guaranteed under the Constitution.

B.

Appellee's Claim.

(Appellee's Brief, p. 106)

Corresponding to the general decline in corporate earnings in 1931 and 1932, of which the District Court took judicial notice was the "more notorious and greater decline in the market price of corporate securities," of which the District Court failed to take judicial notice. It would have been difficult if not impossible to have floated Appellee's bonds at all in 1931; certainly on a 6½% return, equity capital could not have been attracted in 1931 and on a 5½% return could not have been attracted in 1932.

Appellants' Answers.

I.

For the year 1931, the "notorious decline in market prices of corporate securities" had no application to Appellee's securities, or to securities of the same investment rating as those of Appellee. The yield on resale price in 1931 on Appellee's bonds was 4.76%; such yield was .54% lower than the yield on their original offering price in 1923. (R. VII, 4336a). The investor who had purchased Appellee's bonds on their original public offering, or in the years 1923 to 1926, inclusive, and even in the year 1929, could have resold his investment in 1931 at a substantial profit ranging from $91.87 to $10.63 on every $1,000 of Appellee's bonds (Appellants' Brief, p. 484; R. VII, 4336a). The average yield on resale price on bonds of the same investment rating in 1931 as Appellee's (AAA), was lower in 1931 than was their average yield in six of the eight years 1923 to 1930, inclusive (Appellants' Brief, p. 516; Appendix to Appellants' Brief, p. 148). The average yield on resale price of stock in 1931 behind AAA bonds of utilities was 4.97%; such yield was 1.72% higher than the lowest yield, and 1.26% lower than the highest yield on resale price of such stocks during the entire period 1923 to 1930 (R. VII, 4219-21).

Appellee's claim covering the notorious decline in market prices of corporate securities has application, if at all, to lower grade classes of securities in none of which are to be found Bell System securities (Appellants' Brief, pp. 475-6, 480-1, 483, 517). Thus the average yield on resale price in 1931 of A bonds was 6.08%, of BAA bonds was

8.12%, and of BA bonds 11.48% (R. VII, 4213-4). Similarly the average yield on resale price in 1931 of stock behind low grade bonds was: 6.95%, for stock behind A bonds; 8.46%, for stock behind BAA bonds; and 14.36% for stock behind BA bonds (R. VII, 4221, 4218D, Appendix to Appellants' Brief, p. 149).

2.

Appellee's claim that the cost of credit money to Appellee and to other utilities was higher in 1931 than it was in previous years disregards the undisputed facts in the record. No Bell System bond issues were offered in 1931. Appellants direct attention to the financing record in 1931 of AAA bonds of other utilities, such bonds corresponding in investment rating to those of Appellee (Appellants' Brief, pp. 517-8).

Such record shows that for all public utilities which issued AAA bonds in years prior to 1931 and in 1931 the cost of money on the 1931 issue was lower than that of the previous issues:*

Year of Issue	1923	1924	1925	1926	1927	1928	1929	1930	1931
Comm. Edison Co.	5.77%	....	....	5.12%	4.88%	....	....	4.82%	4.42%
Consol. Gas, Elec., Lt. & Power	....	....	5.15%	5.15%	....	....	4.93%	4.75%	4.37%
Public Serv. Elec. & Gas Co.	....	....	....	....	4.78% 5.38%	....	....	4.97%	4.51%
Buffalo Gen. Elec. Co.	....	....	....	5.27%	....	....	....	....	4.62%
Consol. Gas of N. Y.	....	....	5.93%	....	....	....	....	....	4.65%

Similarly the yield on public offering price in 1931 of AAA bonds of public utilities was lower than the yield on

*Sources: R. VII, 4285-4291.

public offering price of AAA bonds of the same issuer, issued in prior years:*

Year of Issue	1923	1924	1925	1926	1927	1928	1929	1930	1931
Comm. Edison Co.	5.52%	5.10%	....	4.95%	4.75%	....	....	4.65%	4.27%
West Penn Power	5.63% 5.83%	....	5.15%	4.97%	....	....	....	....	4.24%
Buffalo Gen'l Elec.	....	....	....	5.06%	....	....	....	....	4.45%
Philadelphia Elec.	5.60%	5.03%	....	....	4.58%	....	....	....	4.34%
Public Service El. & Gas	....	5.72%	....	....	4.61% 5.06%	....	....	4.75%	4.33%
Consol. Gas Co. of N. Y.	....	....	5.50%	....	....	....	....	....	4.42%
Consol. Gas, Lt. & Pr. of Baltimore	....	....	4.97%	4.91%	....	....	4.75%	4.58%	4.22%

The average cost of money in 1931 on AAA public utility bond issues was 4.52 per cent (R. VII, 4195). Such cost was lower than the average cost of money on AAA public utility bond issues offered in every one of the years 1923 to 1930, inclusive (R. VII, 4193-95; Appellants' Brief, p. 518). The average yield on public offering price of AAA public utility bond issues sold to the public in 1931 was 4.33 per cent (R. VII, 4255). Such yield was lower than the average yield on public offering price on AAA public utility bond issues sold to the public in each of the years 1923 to 1930, inclusive (R. VII, 4255; Appendix to Appellants' Brief, p. 146).

3.

Appellee's claim that credit money was more difficult to obtain in 1931 than in prior years has application, if at all, to the lower grade classes of securities, in none of which are to be found Bell System securities (*supra*, 62).

In 1931, $286,000,000 AAA bonds were offered to the public, which amount represented more than 74% of

*Sources: R. VII, 4293-4318.

the entire amount of AAA bonds offered to the public in the period 1923 to 1930, inclusive. On the other hand, the amounts of the A, BAA and BA public utility bonds offered to the public in 1931 represented 9.7%, 1.7% and 1.1% respectively of the entire amount of correspondingly rated bonds offered to the public from 1923 to 1930, inclusive (R. VII, 4255).

Of the total amount in dollars of bond issues offered by public utilities in 1931, 33% and 37% were represented by AAA and AA bond issues, respectively. In the years 1923 to 1930, inclusive, the proportion of AAA and AA bonds of the total amount of bonds offered in each such years ranged from 2% to 13% in the case of AAA bonds, and from 4% to 21% in the case of AA bonds. On the other hand, of the total amount of bonds offered in 1931, the amount of A, BAA and BA bonds represented 25%, 3% and 1% respectively, and the proportion of such low grade bonds of the total amount of bond issues offered in each of the years 1923 to 1930 ranged from 20% to 47% in the case of A bonds, from 10% to 38% in the case of the BAA bonds, and from 5% to 38% in the case of BA bonds (R. VII, 4192B).

The record closed on July 1, 1932, and contains no facts from which comparisons may be made for 1932 as were made for the years prior thereto. However, Moody's Manual of Public Utilities shows that in 1932 the relative stability of Bell System bonds, including Appellee's bonds, was the same as that for prior years; that whereas the yield on resale price on other utility bonds was increasing and reached a high of 17.73% in December of 1932, the Bell System bonds, including those of Appellee, were steadily decreasing and reached a low of 4.50% in December of 1932 (Appellants' Brief, p. 486).

Appellee's claim therefore depends on the principle that the required rate of return to Appellee should be determined on the basis of securities of a substantially inferior investment rating.

III.

Appellee's Claim.

(Appellee's Brief, p. 109.)

The required minimum return for each of the years 1923 to 1930, inclusive, as found by the District Court, was less than that which was shown proper by Appellee's witnesses and less than that allowed in other cases by this Court.

Appellants' Answers.

A.

The testimony of Appellee's witnesses consists of prognostications which are fatally defective, because:

1. The prognostications of Appellee's witnesses are contrary to Appellee's actual experience and to the comparable experience of the other Associated Companies (Appellants' Brief, pp. 450-1, 449, 463, 479, 482, 485).

2. The prognostications are based on five assumptions which have no application to Appellee's actual experience and to the comparable experience of the other Associated Companies (Appellants' Brief, pp. 450-1).

3. The prognostications are based on general unsupported statements in an important and intricate field and should not be accepted as adequate proof to sustain confiscation (Appellants' Brief, p. 507; R. I, 199-200).

B.

The returns of other cases cited by Appellee as having been sustained by Courts have no application to the instant case because:

(1) The total return to the investor in such other cases embraced only "cash income available for return" but in the instant case such return embraced such cash return plus advantages of additional profit created at Appellee's expense for the benefit of the American Company as its investor (Appellants' Brief, pp. 463-70, 480, 482-3, 486).

(2) The discussion in respect to 8 per cent return in three of the cases relied on by Appellee was academic.

In *Consolidated Gas Co.* v. *Prendergast* (6 Fed. (2d) 243 (1925)), the rates complained of were not sufficient, on any theory, to yield a return of more than 4.13 per cent for the years 1922-1924 (*Ibid*, at 273). The public conceded that a return lower than 6 per cent was confiscatory, and obviously there was no necessity for going into any 8 per cent rate (Record on appeal: *Ottinger* v. *Consolidated Gas Company*, 272 U. S. 576; Brief for Attorney General, pp. 109-117).

In *Kings County Lighting Co.* v. *Prendergast* (7 Fed. (2d) 192 (1925)), the revenues from the rates complained of, after absorbing high interest charges ranging from 5 per cent to 6½ per cent on bonds, and from 7 per cent to 8 per cent on preferred stock, would have left practically nothing for the common stock (*Ibid*, at 211, 209). The rate of return on the rate base found by the Master was 2.94 per cent, and on the rate base contended for by the public was less than 5 per cent (*Ibid*, at 205, 213). In this case as

well, the public had conceded that a return lower than 6 per cent was confiscatory (Record on appeal: 272 U. S. 579; Brief for Attorney General, p. 59).

(3) There was no statement by the Court of any specified rate of return necessary to avoid confiscation in two of the cases relied on by Appellee.

In *Southwestern Bell Telephone Co.* v. *Fort Smith* (294 Fed. 102 (1923); 270 U. S. 627 (1926)), the main point determined was whether or not going value is a proper element to be considered in making rates for telephone service. The District Court held that it was. All that is said with regard to the rate of return is as follows:

> "By allowing a valuation of $685,605, which includes a going value of 10 per cent, and by reducing the annual depreciation to 4 per cent, the city shows a return of 6.29 per cent. Its engineer admits that a fair return would be 8 per cent" (*Ibid*, at 108).

There was no discussion as to whether the 8 per cent was to be an over-all rate, and it is quite clear that there was no evidence taken upon this point, since the City's own engineer admitted that a fair return would be 8 per cent.

In *Brush Electric Co.* v. *Galveston* (262 U. S. 443 (1923)), there was no question as to the confiscatory nature of a return of less than 8 per cent. This Court held that in the light of the conflicting evidence, an actual test of the rates should be made.

(4) The other cases relied on by Appellee are totally inapplicable to the facts in the record concerning Appellee.

In *Mobile Gas Co.* v. *Patterson* (293 Fed. 208 (1923); 271 U. S. 131 (1926)), it appeared that the company paid no dividends during the first eight years of its operations; during the next four years the rates of dividend paid by it

ranged from 2.66% to 5%; and since December 31, 1917, it paid no dividends (*Ibid,* at 222-3). From the order of the Commission it appeared that, with the low rate then fixed, the company was not able even to meet its actual operating expenses, and that the rates in question would have yielded less than 2.5 per cent on the rate base value contended for by the public (*Ibid,* at 224). But such facts are opposite to those which the record shows for Appellee.

The 7.44 per cent return in *United Rys. & Electric Co.* v. *West* (280 U. S. 234 (1930)), was applied for 1927 to a rate base value which was $1,000,000 less than its capitalization (*Ibid,* at 248). As the annual charges on outstanding credit obligations and preferred stock exceeded 7 per cent, the 7.44 per cent return for 1927 was not sufficient to pay more than 7.34 per cent return on the outstanding stock. In the light of its financial history* and unbalanced corporate structure (Record, *United Rys.* v. *West, supra,* pp. 533-4), such a return was clearly a minimum on any theory. But such facts are opposite to those which the record shows for Appellee (Appellants' Brief, pp. 463, 470, 472, 477, 479, 482, 486, 524-6).

*The United Railways Company paid no dividends prior to 1912, 4% through 1919, none in 1920-21, 2% in 1922, 4% in 1923 to 1926, and none thereafter (Record, United Railways Case, Vol. V, p. 1476).

APPELLEE'S CLAIMS COVERING DEPRECIATION EXPENSE ALLOWANCES.

I.

Appellee's Claim.

(Appellee's Brief, pp. 53, 58)

Appellee's judgment of the proper depreciation expense charges should have been followed by the District Court as a managerial act which had not been shown to be arbitrary or otherwise improper.

Appellants' Answer.

The right to originate the amount of depreciation expense charges and to make changes therein as part of the managerial acts of utilities was taken away from them by Section 14 of the Illinois Public Utilities Act and was placed in the Commission (Appellants' Brief, p. 383). Even if Appellee had such right, its exercise thereof by including under the label of depreciation expense charges, advance contributions for anticipated depreciation on contemplated future additions to buildings and central office equipment, and by giving effect in connection therewith to the reproduction cost new estimates of its property, rendered its showing thereon fatally defective (Appellants' Brief, pp. 395, 433).

II.

Appellee's Claim.

(Appellee's Brief, p. 66)

The District Court should not have given any consideration to the 1920 Order on depreciation expense allowances because: (a) the Order was a temporary one and as such could not determine depreciation expense charges, (b) the Order was superseded by the 1923 Order, and (c) the Order covered "retirement" and not "depreciation" expense charges.

Appellants' Answer.

Appellee's objections to the 1920 Order on depreciation expense allowances insofar as the allowances therein provided should have been used by the District Court in determining the net income under the existing telephone rates established by the same Order, are raised for the first time in this Court in a collateral proceeding in which Appellee seeks the advantage of the Order in respect to the telephone service charges specified therein (*United Fuel Gas Co.* v. *R. Commission of Ky.*, 278 U. S. 300 (1929)); for the reasons stated in Appellants' Brief, pages 389-392, Appellee's objections should be disregarded.

III.

Appellee's Claim.

(Appellee's Brief, p. 67)

The District Court should not have given any consideration to the 1923 Order on depreciation expense allowances, because:

A. In a confiscation case, the Commission's findings of fact are not competent evidence;

B. The language of the 1923 Order covered "retirement" and not "depreciation" expense charges.

C. The allowances by the 1923 Order were so grossly inadequate as to be void in that the aggregate of such allowances for the period 1923 to 1931, inclusive, barely covered the retirements of the same period.

Appellants' Answers.

Appellee's objections to the 1923 Order on depreciation expense allowances should be disregarded because:

A.

Appellee's claim that in a confiscation case involving the 1923 Order on telephone rates the Commission's Order on depreciation expense allowances is not competent evidence disregards the evidentiary value attaching to a legislative act pursuant to Section 14 of the Illinois Commerce Commission Law (Appellants' Brief, p. 392) and the holding of this Court in *Los Angeles Gas & Electric Corp.* v. *Railroad Commission*, 289 U. S. 287, at 304-5 (1933).

B.

Appellee's claim that the language of the 1923 Order on depreciation expense allowances covered retirement and not depreciation expense charges disregards the facts that:

(1) Appellee concedes that for five years following the date of the Order, to-wit: 1923 to 1927, inclusive, the Commission's allowances covered actual retirement charges and provided in addition from $1,090,000 to $1,950,000 per year for *future retirements,* aggregating for the period $7,180,000 (Appellee's Brief, p. 111). The special reasons why the depreciation allowances beginning with 1928 did not exceed actual retirements are discussed later (*infra,* 75).

(2) Appellee made the same attack on the form of the Order before this Court leading up to this Court's Opinion of December 1, 1930 (282 U. S. 133, Brief for Appellee, pp. 53-7). But the Opinion of this Court did not mention that point and shows clearly that the 1923 Order in respect to depreciation expense allowances was treated as covering depreciation expense charges.

(3) The discussion in the 1923 Order used interchangeably the terms "future requirements for . . . . replacements". (O.R. I, 34, 35); "annual requirement to cover depreciation" (*Idem,* at 35); "retirement requirements" (*Idem,* at 35); "replacement allowance . . . . to accrue a reserve in the anticipation of property retirements" (*Idem,* at 36). In commenting on the findings to be made for plant in service (*Idem,* at 36) the Commission says: "In the findings hereinafter the Commission will base its maintenance and depreciation allowance." In the next sentence referring to the allowance covering work in progress and future additions, the Commission uses the term "maintenance and

replacement allowance." In the final finding, the Commission refers to both of these items in the same sentence and uses the term "fair allowance to take care of maintenance and retirement charges" (Appellee's Brief, p. 67). Appellee's claim reads into the term "retirement charges" the additional words "of property in service actually retired in the year of the allowance." The Commission stated, however, that its findings would provide an allowance "to accrue a reserve in anticipation of property retirements" (*supra*, 73). Such an allowance is the "depreciation charge" which was defined by Mr. Justice Brandeis as "an allowance made pursuant to a plan of distribution of the total net expense of plant retirement" (*United Railways* case, 280 U. S. 234 at 264). The reserve intended by the Commission to be accrued "in anticipation of property retirements" is the reserve to which Mr. Crunden and Mr. Belcher, the American Company's experts on Depreciation, referred in their article "The Straight Line Depreciation Accounting Practice of Telephone Companies in the United States" (R. VI, 3776 at 3781-2):

> "It is, of course, evident from what has just been said that the Bell System depreciation reserve is a **retirement reserve**, not a replacement reserve." (Bold face ours.)

C.

Appellee's claim that the allowances by the 1923 Order were so grossly inadequate as to be void based upon the relation of the aggregate thereof for the period 1923 to 1931, inclusive, considered as a single unit of time to the aggregate retirements for the same period of time considered as a single unit of time, disregards the facts that:

(1) For each of the years 1923 to 1927, inclusive, such allowance exceeded retirements (*supra*, 73) by a wide margin. As to these years no issue arises even under Appellee's claim.

(2) For the years 1928 to 1931, inclusive, the fact that the allowances did not exceed the actual retirements of the same years* has no significance to void the allowances because:

(a) There is no relation between the allowance in a given year and the retirements of that year where the depreciation expense charges are computed on the straight line method. Obviously the allowance in 1923 or 1928 or in any other year applicable to any unit retired in such year covers only a fraction of the loss realized by the retirement in that year of that unit, for which loss, depreciation expense charges of prior years have been accumulated. Appellee's depreciation rate for manual central offices was 6.9% and for buildings 3.2% of the book cost, including the last year of service life of each building and of each unit of central office equipment respectively (Appellants' Brief, pp. 372-3).

The lack of uniformity and the lack of relation of current retirements to current depreciation expense charges (R. VI, 3779) are illustrated by Appellee's own experience in respect to central office equipment and for all of its plant.

Beginning with 1923, the first year in which the Commission's Order would have been effective, Appellee began to place in service panel machine switching central office equipment (R. II, 1282). This marked the beginning of its

*The deficiency in 1931 was $102,000; in 1928, $167,000; in 1930, $1,700,000; and 1929, $3,012,000 (Appellee's Brief, p. 111).

program to retire all of its manual equipment by the end of 1944 (R. II, 1110). Much of this equipment was installed prior to 1910 (R. IV, 2864A). Appellee retired less than $2,000,000 of central office equipment during the nine year period 1914-1922, inclusive (R. VII, 4076 a-b), but retired the following amounts during the period under investigation (R. IV, 2776a-2777):

1923	$483,441	1928	$ 818,367
1924	546,616	1929	4,552,317
1925	410,316	1930	1,385,708
1926	212,682	1931	2,235,574
1927	548,847		
		Total	$11,193,868

Obviously the heavy losses realized through the retirements of the last three years bear no relation to the current depreciation expense charges of the same three years.

For the four year period 1928 to 1931, inclusive, the retirement loss for all plant ranged from 55% to 86% of Appellee's current recorded depreciation expense charges; for the five year period 1923 to 1927, inclusive, the range was from 32% to 44%; for the five year period 1918 to 1922, inclusive, the range was from 15% to 23% (R. VII, 4070).

(b) Appellee's comparison of the allowances with the retirements presents a distorted picture in that: (1) the retirements include general equipment for which Appellee made a separate provision by charges to certain clearing accounts from which the cost is distributed. The failure of Appellee (R. IV, 2780; R. II, 1718-20) to include the provisions therefor, together with certain miscellaneous credits, made the showing (Appellee's Brief, p. 111) unduly favorable to Appellee by annual amounts ranging from $109,000 to $225,000 in the period 1923 to 1931. The proper inclusion of these amounts would convert the deficits of 1928 and 1931 to excesses of allowance over retirements.

(2) Appellee changed its depreciation accounting methods on exchange aerial wire beginning with 1929, the effect of which was to increase the operating expense thereafter by charges applicable to the depreciation reserve of $600,000.* Such charges are a cushion to be added to the depreciation allowances beginning with 1929. (3) Appellee's retirements of telephone instruments beginning with 1928 are unduly increased because they were *second hand instruments* (*supra*, 45), against which a 48% reserve had been accumulated by the American Company but in respect to which only an 18% deduction was made from the American Company's cost when sold to Appellee (*supra*, 45). The current depreciation expense allowed by the Commission's Order contemplates provision for a portion of the amount necessary to cover the losses realized from retirement actually taking place plus a reserve for the future retirements of plant in service on the basis that property added is new property with full service life. But it is one thing to have the schedule of retirements begin with 1928 on the basis that the additions to the property account are new property with the full service life to be included in the computations of depreciation expense and it is quite another thing to throw into the retirement schedule second hand property whose service life was over or largely used up at the date of purchase. The picture must inevitably become distorted. A look at the picture of Gross Additions, Retirements and Net Loss realized from Retirements of station apparatus for the years prior to and subsequent to the purchase of the telephone instruments is instructive, as set forth in the Appendix (Appendix, *infra*, 112).

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*Prior to 1929 Appellee applied its depreciation accounting to aerial wire, accumulating a reserve of over $600,000 (R. VII, 4083) from charges ranging from $106,000 to $194,000 for the period 1923 to 1928. Subsequent to 1928 Appellee has charged replacements direct to expense instead of to the reserve provided therefor (R. II, 1725).

(c) Inadequacy due to growth of the service was the greatest factor in the retirement of property during the period prior to 1930 (R. VI, 3779; R. I, 755; R. II, 1099; O.R. II, 898-9, 909; 177 I. C. C. 351, at 383 and 401). The depression eliminated that factor for many years to come.

From 1923 to 1929, inclusive, the increase in stations ranged from 39,000 to 58,000 per year, the total increase aggregating 296,000 (Appendix to Appellants' Brief, p. 37).

During this period the increase in book cost of fixed plant ranged from $10,000,000 to $15,000,000 per year, the total increase aggregating $82,000,000 or 82% of the amount of plant in service at the beginning of the period (R. VII, 4078).

Appellee lost 6,000 stations in 1930, and 42,000 stations in 1931 (Appendix to Appellants' Brief, p. 37); it estimated the loss in stations in 1932 to be 75,000 (R. II, 1081). On December 31, 1931, the number of stations in service was less than on December 31, 1928, although the fixed plant on later date exceeded by $25,000,000 the fixed plant of December 31, 1928 (R. VII, 4078-9).

The depreciation expense charges and allowances from 1923 to 1929, inclusive, gave effect to inadequacy as a principal cause of retirement. In testing the adequacy of such charges and allowances in the light of Appellee's actual experience, consideration must be given to the fact that on account of the depression the factor of inadequacy covered by them was eliminated in respect to the property remaining in service in 1930 to which they had application. Appellee's claim that the Commission's allowances were inadequate give no such consideration.

(d) The relation of the net increase in the depreciation reserve to the net increase in plant during the period of the

allowances is without significance in the absence of a showing of the relation of the net increase *plus the depreciation reserve* already accumulated at the date of the allowance to the investment in service to which they have application (*Smith* v. *Illinois Bell Tel. Co.*, 282 U. S. 133 at 158). Appellee made no such showing. In this connection, consideration must be given to the facts that: (1) Giving effect to the Commission's 1923 Order on Depreciation Expense allowances, the percentage of Appellee's Depreciation Reserve to the Chicago Intrastate property would still be from 2 to 10 times the corresponding percentage applicable to the Illinois Division property, would be the highest percentage in 1923 in the Bell System, and would exceed in percentage that of 24 companies in the Bell System in 1924, that of 20 in 1925, that of 18 in 1926, that of 17 in 1927, that of 15 in 1928, that of 14 in 1929, and that of 12 in 1930. No corresponding data is available for 1931 (R. VII, 4088A). (2) The depreciation expense accumulations prior to 1923 gave effect to inadequacy as a principal factor in the retirement of property, which factor was eliminated since 1929 by the depression in respect to all property then in service and installed prior to 1923. (3) The depreciation expense accumulations prior to 1923 included advance contributions for anticipated depreciation on contemplated future additions to buildings and central office equipment (R. II, 1107). The deferment, because of the depression, of the date for the placing in service of such additions (Appellants' Brief, pp. 414-5) makes the amount of such advance contributions included in the depreciation reserve available for reimbursement for retirement loss on "property in service" and not otherwise reimbursed.

APPELLEE'S CLAIMS COVERING DEPRECIATION IN VALUATION.

Appellee's Claim.

(Appellee's Brief, 23-36.)

The District Court stated that in arriving at the rate base it was necessary to give effect to the "actual existing depreciation in valuation in the property as compared with the new one." Such statement follows the principle of law enunciated by this Court in the *Minnesota Rate Cases*. *Actual existing depreciation* is determined by inspection and not by the company's records and means the depreciation which is apparent upon inspection. Appellee's presentation was based upon an inspection the thoroughness of which was admitted. The District Court's findings of depreciation in valuation exceeded the amounts shown by Appellee. Such excess ranged from $9,300,000 to $13,800,000 per year.

Appellants' Answer.

Appellee's claim is fatally defective in that:

A. Appellee concedes that its inspection was not concerned with "future inadequacy or obsolescence"; nor with anything "that might occur subsequent to the date of the inspection, but has not yet happened—because of physical changes, because of future public requirements, of future changes in the public demand" (Appellee's Brief, p. 33).

Appellee's position on "actual existing depreciation" in its property in service, for valuation purposes, is a re-

pudiation of the basis on which its depreciation reserves were built up through current charges against income from the moment such property was placed in service.* Such basis was that

> "in addition to providing for deterioration actually in evidence the reserve provides for facts and contingencies *which may not yet be manifest, but which from past experience, are certain of realization, e. g.*, obsolescence, inadequacy, public requirements, casualties etc. *within the period of service life* on the basis of which the reserve is set up." (R. VI, 3758. Italics ours.)

B. Although this Court in the *Minnesota Rate Cases* did not define the scope of "actual existing depreciation" for valuation purposes, it is apparent that such depreciation was viewed as covering more than the factors leading to loss in value, whose effects are manifest upon inspection at any given moment during the service life of such property:

> "The Master allowed the cost of reproduction new without deduction for depreciation. It was not denied that there was depreciation in fact. As the Master said, 'everything on and above the road-bed depreciates from wear and weather stress. The life of a tie is from eight to ten years only. Structures become antiquated, inadequate and more or less dilapidated. Ballast requires renewal, tools and machinery wear out, cars, locomotives and equipment, as time goes on, are worn out or discarded for newer types'" (230 U. S. 352 at 456).

To provide for reimbursement of the property cost of the property used up in the service through these forseeable causes, the carriers invested in additional plant during the service life and pending the retirement of the original prop-

*The record shows, as to manual, central office equipment and buildings, the difference in result between the deduction from valuation new made by Appellee on the basis of inspection, and what the deduction would have been had Appellee considered for depreciation in valuation purposes the same causes of property retirement as it did for depreciation expense purposes (R. VII, 4084-7).

erty a portion of the current income and charged such amount to operating expense. (*Minnesota Rate Cases*, 230 U. S. 352 at 457; *Illinois Central Ry. Co.* v. *I. C. C.*, 206 U. S. 441 at 461-2).

The failure by the carriers and by the Master to give specific consideration to such reimbursement was held by this Court in the *Minnesota Rate Cases* to be error (230 U. S. 352 at 457).

C. Appellee gave no effect to this consideration: The applicable principles covering the deductions from rate base value new to arrive at the rate base for rate-making purposes, as set forth by this Court in the *Minnesota Rate Cases*, and as required for the instant case, arise from the basis on which the depreciation expense charges were established in each case and the method of accounting for the proceeds thereof and for the propery on account of which such depreciation charges were collected. Thus:

Property in Service.

Example I.

Assume rail trackage placed in service on January 1, 1901, costs $10,000,000, as recorded in the carrier's plant account. To December 31, 1905, the carrier purchased new trackage aggregating $1,000,000 taken from income for the purpose of offsetting the gradual depreciation in the original trackage pending its retirement, which depreciation it recognized was taking place through wear and tear, weather stress, inadequacy and obsolescence.

Under the accounting practice in effect prior to July 1, 1907*, the cost of such additional trackage would have been

*The *Minnesota Rate Cases* cover the period 1907-8 but the major portion of the investments had been made and recorded under accounting practices in use prior to 1907 (230 U. S. 352, 456-7).

charged to operating expense but would not have been recorded in the carrier's fixed capital account (*United States* v. *Kansas Pacific Railway Co.*, 99 U. S. 455, at 459; *Union Pacific R. R. Co.* v. *U. S.*, 99 U. S. 402, at 420-422; *Illinois Central Ry. Co.* v. *I. C. C*, 206 U. S. 441, at 461-462). By this process the carrier's original dollar investment, as recorded on its books, was maintained unimpaired (*Knoxville* v. *Knoxville Water Co.*, 212 U. S. 1, at 13-14 (1909)), although the units in service were not always the same as those covered by such recorded dollar investment.

On such basis it is clear that:

If the rate base value new on December 31, 1905, is measured by the recorded dollar investment, such rate base value will *not* give effect to the $1,000,000 additional trackage charged to operating expense, but which had never been recorded in the fixed capital account. The carrier will not receive a return on such $1,000,000. To make any deduction from the $10,000,000 recorded dollar investment to arrive at the rate base on which to allow a return, will, therefore, unduly burden the carrier.

Similarly, unfairness to the carrier would be effected if any deduction were made from the rate base value new to arrive at the rate base on which to allow a return when such rate base value new is determined by the conversion of the recorded dollar investment to current values through the use of index numbers.*

On the other hand, if the rate base value new on December 31, 1905, is determined by an appraisal of the *units* found by an *inventory*, such determination *will* give effect to the *units originally* placed in the service and covered by

*Appellee used index number conversions and not inventory and appraisal valuations (Appellants' Brief, p. 333).

the $10,000,000 recorded cost and to the *additional units* costing $1,000,000 *subsequently* placed in the service for the express purpose of offsetting the gradual depreciation of the original investment. Under such circumstances, the carrier would be unjustly enriched if no deduction were made from such appraised valuation to give effect to the $1,000,000 reimbursement.

In the *Minnesota Rate Cases* the *rate base value new* was determined by *inventory and appraisal.* This Court there required that proper deduction be made to arrive at the rate base to avoid such unjust enrichment. Obviously, the proper deduction would be equivalent to the value of the units acquired with the depreciation expense moneys (Appellants' Brief, pp. 370-1). This Court found error in the failure of the Master to make such deduction on the ground, as he claimed, that intangible values not otherwise included in the rate base had equivalent values.

Example II.

Vary the carrier's accounting practice in Example I to the extent that (a) straight line depreciation expense charges of $1,000,000 are deducted from current income; (b) this $1,000,000 is used to acquire additional trackage; (c) $1,000,000 is added to the recorded fixed capital account as the $1,000,000 additional trackage is placed in service; and (d) no deduction is made from the recorded dollar investment in the fixed capital account covering the original investment pending its retirement from service. Such variation would then conform the carrier's accounting practice to that used by Appellee for depreciation expense purposes. Under such circumstances, Appellee's practices like those of the carriers are intended to provide

other investments "so that as items of plant are used up they are replaced by other investments in like amounts. In this way the capital is maintained unimpaired." (Quotation by Interstate Commerce Commission from Bell System Brief filed in proceedings on *Depreciation Charges of Telephone Companies,* 177 I. C. C. 351, at 399).

In such case, if the rate base value new is determined as of December 31, 1905, either on the basis of the recorded dollar investment ($11,000,000), or on the basis thereof as converted to current values by index numbers, or on the basis of an appraisal of the *units* found by *an inventory,* proper deduction must be made therefrom to avoid the unjust enrichment of the carrier. Under such circumstances, the proper deduction would be equivalent to—(a) the dollars added to the fixed capital account, if the recorded dollar investment is used to measure the rate base value new; (b) such added dollars converted by the index number ratios used to convert the recorded dollar investment, if the rate base value new is determined by the use of index numbers applied to the recorded dollar investment; and (c) the appraised value of the units acquired with the depreciation expense moneys, if the rate base value new is determined by inventory and appraisal (Appellants' Brief, p. 371).

Contemplated Future Property.

Example III.

Vary Example II to the extent that (a) the carrier in 1901 foresees that the $10,000,000 trackage installed in 1901 will remain in service to 1951, but will then be retired. It contemplates, however, that a spur track will be required in 1941 at a cost of $2,000,000 and that this spur track will be abandoned and retired from service in 1951 when the

main trackage is retired. The carrier begins in 1901 to charge against current gross income advance contributions of equal monthly amounts to accumulate by 1941, $1,230,800 for anticipated depreciation after 1941 in the contemplated $2,000,000 investment to be placed in service in that year.* These contributions the carrier labels "depreciation expense charges." By December 31, 1905, such advance contributions are $153,850; (b) the carrier invests in plant the $153,850; and (c) adds the amount thereof to its recorded fixed capital account. Such variation would conform the carrier's accounting practice to that of Appellee covering depreciation expense charges on buildings and central office equipment (Appellants' Brief, pp. 395-6, 399-400).

The carrier's recorded fixed plant account would show on December 31, 1905:

1901	Original Investment	$10,000,000
1901-05	Plant acquired by use of Depreciation Expense Monies	
	(a) Depreciation on Original Plant. 5 yrs. @ 2%	1,000,000
	(b) Advance Contributions	153,850
12/31/05	Total	$11,153,850

*"The amount of the advance contributions are computed as follows:

Investment	Life	Dollar Years
$10,000,000	50	$500,000,000
2,000,000	10	20,000,000
$12,000,000		$520,000,000

$520,000,000 ÷ $12,000,000 = 43.3333 years, which is the average life after giving effect to the shorter life of the later investment.

100% (original cost) minus salvage (none) divided by average life (43.3333 years) = depreciation rate of 2.3077%. Since the original unit is to live 50 years its depreciation rate would be 2%; therefore the excess of .3077% which is annually applied to the original investment of $10,000,000 produces the following advance contributions:

First five years	$ 153,850
First forty years	$1,230,800

In such case, if the rate base value new is determined as of December 31, 1905, either on the basis of the recorded dollar investment ($11,153,850) or on the basis thereof converted to current values by index numbers, or on the basis of an appraisal of the units found by inventory, proper deduction must be made therefrom to arrive at the rate base to avoid the unjust enrichment of the carrier. In addition to the deduction of $1,000,000 required in conformity with the principles underlying Example II, *supra*, deduction would be required to avoid the unjust enrichment from the $153,850 collection in advance of the date when the carrier is entitled to receive the return thereon (Appellants' Brief, p. 363). But such deduction ($153,850) could not be made on Appellee's literal interpretation of "existing depreciation in the property" covered by the *Minnesota Rate Cases;* the property to which the accumulations have application was not in service in 1905.

Depreciation Reserve.

Example IV.

Add to the accounting practices in Example III the following accounting practices: (a) the depreciation expense accumulations covering property in service and advance contributions applicable to contemplated future additions are recorded as one separate account called the "depreciation reserve" and (b) the depreciation reserve is reduced by property retired. Such additional provisions will complete Appellee's accounting practice covering depreciation expense charges and the disposition of the funds derived therefrom and of the property to which such funds have application.

In such case, the balance in the depreciation reserve will at all times measure (a) the recorded dollars added to the recorded fixed capital account to cover property placed in service which additions had been acquired with depreciation expense moneys, pending the retirement from service of property originally placed in service of corresponding dollar amount and not yet written off the books; and (b) advance accumulations pending the placing in service of contemplated future additions.

The deductions required in Example III to prevent unjust enrichment would therefore be equivalent to the amount of such balance where the rate base value new was based on the recorded dollar investment and equivalent to the amount of such balance adjusted to current values where the rate base value new was based on current values (*supra*, 85). But after giving effect to such deductions, the total funds obtained by Appellee from the issue of securities plus surplus earnings would still be covered by rate base value (R. VII, 4228A-B, *supra*, 59).

APPELLEE'S CLAIMS COVERING THE DISTRICT COURT'S CUT IN VALUATION IN 1930 AND THEREAFTER TO ELIMINATE THE EFFECT OF THE 1930 PRICE INCREASE BY WESTERN.

The District Court eliminated the effect of the 1930 increase of 10% in Western's prices in arriving at the fair value of Appellee's property for the years 1930, 1931 and 1932. The effect of this elimination was to reduce the valuation of Appellee's property by more than $4,750,000 in each of such years. Appellee assigned error thereon and in support urged four claims.

I.

Appellee's Claim.

(Appellee's Brief, p. 38)

The price increase was justified in view of the fact that the 1929 reduction of 8.29% was made because Western anticipated a large increase in the volume of the Bell business which was not realized.

Appellants' Answer.

Appellee's claim is based on the same fundamental errors which Appellants pointed out existed in its presentation on Western's Profits and Prices and on Rate Base Value on which the District Court's findings on such subject matters were based (Appellants' Brief, pp. 294-6, 306, 345-6, 351).

If it be assumed that Western's increase in price in 1930 and thereafter was justified because of the abrupt drop in sales in such years, it would not justify the use of such increased price to *revalue* Appellee's property as the volume of purchases in the reproduction program would exceed by far the current purchases actually made (Appellants' Brief, pp. 343-6).

II.

Appellee's Claim.

(Appellee's Brief, p. 39).

Even after the increase, Appellee would have purchased from Western its materials at prices below those of other manufacturers.

Appellants' Answer.

The consideration that Western's prices to the Bell System are lower than those of other manufacturers does not prove that Western's prices are reasonable in the absence of a showing that the comparison gives effect to the reduction and elimination of expense of production and of distribution made possible by Western's relationship to the Bell System. No such showing was made (Appellants' Brief, pp. 284-6). On the contrary it appears that Western's prices in 1931 and 1932 were based on standard costs which gave effect to 15-cent copper, although the actual prices paid therefor were 10.4 cents and 6.25 cents, respectively; to 8-cent lead, although the actual prices paid therefor in

these years were 5.6 cents and 4.22 cents, respectively, and to the labor wage scale established in 1929 (Appellants' Brief, 252-3; 269; R. V, 3717; R. I, 379; R. II, 1600). It is inconceivable that other manufacturers not enjoying a monopoly control over their customers would predicate prices in the depression on any such basis.

III.

Appellee's Claim.

(Appellee's Brief, pp. 39, 41)

Even after the increase, Western's profits from Bell business, as found by the District Court, were reasonable.

Appellants' Answer.

Appellee's claim that Western's profits from Bell business in 1931 and 1932 are reasonable is based on the District Court's findings thereon and as such is fatally defective in that it assumes contrary to fact:

(1) the proper separation of Western's total operating expenses between Bell and non-Bell business (Appellants' Brief, p. 247);

(2) the proper separation of Western's manufacturing facilities between Bell and non-Bell business (Appellants' Brief, p. 261);

(3) the proper allocation of Western's Development and Research expense between Bell and non-Bell business (Appellants' Brief, p. 271);

(4) the relation of Western's profits on Bell sales, to its sales to Appellee in each of these years (Appellants' Brief, p. 277);

(5) the significance, as a yardstick by which to determine the reasonableness of Western's earnings on Bell business, of the percentage figures related to Western's depreciated and undepreciated "average investment" in Bell business as found by the District Court (Appellants' Brief, p. 296).

Appellants direct attention that Western's showing of net earnings of $10,500,000 for 1931 from $219,000,000 sales to the Bell System was the same as Western's showing from its estimated $256,000,000 sales to the Bell System for the same year (Appellants' Brief, p. 270). These showings and Appellee's contentions that the 1930 increase was necessary to offset falling volume (*supra,* 89) can not be reconciled.

IV.

Appellee's Claim.

(Appellee's Brief, pp. 41-43)

The District Court's findings on the reasonableness of the relationship between Western and the Bell System for the period of the litigation and to 1916 justified the price increase in 1930.

Appellants' Answer.

Appellee's claim that the relationship between Western and the Bell System for the period 1923 to 1932, inclusive, and for the period 1916 to 1932, inclusive, was advantage-

ous to Appellee and justified Western's price increase in 1930 is based on the District Court's findings thereon, and as such is defective because:

(1) The issue on Western's Profits and Prices does not relate to an abuse of inter-corporate relationship to be viewed in the light of the relationship over a period of years. The issue on Western's Profits and Prices is one of confiscation for each year of the litigation based upon the use of Western's prices to arrive at the estimates upon which the charge of confiscation for each of the years of the litigation was predicated and sustained (Appellants' Brief, p. 233).

(2) The District Court's finding of reasonableness based upon the results of a period of years and not merely of a single year precludes the determination of the reasonableness of Western's prices used in the estimates upon which Appellee's charge of confiscation for each year of the litigation was predicated and sustained (Appellants' Brief, p. 281).

(3) The standards applied by the District Court to determine the reasonableness of Western's Bell Profits and Prices did not and could not determine their reasonableness for any one year or over a period of years (Appellants' Brief, p. 284).

MAINTENANCE EXPENSE.

(Appellee's Brief, p. 103.)

Appellee's Claim.

The District Court's finding which reduced maintenance expenses in 1930 and thereafter to undo the effect of the 1930 increase in Western's prices is erroneous for the reasons stated for its error in reducing the valuation of Appellee's property on account thereof.

Appellants' Answer.

Appellants' answer to Appellee's claim covering the reduction in Valuation (*supra,* 89) is a conclusive answer to its claim on Maintenance Expenses.

THE DISTRICT COURT'S UNDERVALUATION IN 1931 AND 1932.

Appellee's Claim.

(Appellee's Brief, pp. 45-50.)

The District Court's finding of fair value for 1931 was $18,500,000 less than the total of its separate findings of the reproduction cost new of the property plus the other items of value. $4,500,000 is attributable to its findings on Western's prices and $14,000,000 to its findings that it was giving effect to "the general decline in property values" in these years. Such $14,000,000 reduction was erroneous because Appellee's reproduction cost new estimates for 1931 were based on its experience which gave effect to all conditions which resulted in lessening of the value of its property.

Similar error was committed by the District Court's findings for fair value for 1932, which cut the valuation by $23,000,000, even though no reproduction cost new estimate was in the record.

Appellants' Answer.

Appellants construe the District Court's reduction in values for 1930 and thereafter as intending to undo the 10.2% increase in Western's prices in 1930 so as to maintain the 1929 level of prices as stated by the District Court (Appellants' Brief, pp. 345, 349, 351). On such construction, Appellee's claim fails.

If Appellee's construction is correct, its claim is nevertheless fatally defective in that:

A. It assumes, contrary to fact, that it is possible to determine the extent to which Western's prices have entered into its reproduction cost estimate (Appellants' Brief, p. 315).

B. It preserves all the errors which render the reproduction cost new estimates fatally defective as the basis for fair value determination (Appellants' Brief, pp. 328-346).

C. It disregards the specifications of the *McCardle* Case in respect to a forecast of probable future price levels (Appellants' Brief, p. 347).

D. It assumes, without proof, that the price level of 1931 was maintained in 1932 and 1933.

E. It assumes that a purchaser would have paid the full price for the plant which was built to take care of the predepression demand.

F. Appellee's claim, if allowed, will increase the incongruity of the District Court's finding of Required Minimum Return (Appellants' Brief, pp. 502-3).

On the tests of compensatory rates applicable in the instant case, the increase in valuation will not affect the result (Appellants' Brief, pp. 482-5; 494-7).

CONCLUSION.

Appellee's Cross-Appeal is based on the arbitrariness of the District Court's fiats on the several issues on which its determination of confiscation was predicated. But Appellee's claims of what the proper determinations on such issues should have been are themselves arbitrary; they do not give effect to the facts of its own experience.

Respectfully submitted,

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APPENDIX.

STATION TO STATION SEPARATION AND APPORTIONMENT OF EXPENSES BY YEARS.

(Excluding All Overheads on Lands.)
(R. IV, 2734-42.)

Year	Total Chicago Area Amount	Total Chicago Area Percentage	Interstate Toll Amount	Interstate Toll Percentage	Total Chicago Intrastate Amount	Total Chicago Intrastate Percentage
1923	$32,732,054	100%	$1,245,856	3.81%	$31,486,198	96.19%
1924	34,585,244	100	1,318,848	3.81	33,266,396	96.19
1925	37,298,344	100	1,555,174	4.17	35,743,170	95.83
1926	40,698,361	100	1,819,396	4.47	38,878,965	95.53
1927	43,951,533	100	2,088,850	4.75	41,862,683	95.25
1928	48,633,875	100	3,080,218	6.33	45,553,657	93.67
1929	54,004,988	100	5,959,109	11.03	48,045,879	88.97
1930	55,537,767	100	6,088,439	10.97	49,449,328	89.03
1931	54,145,007	100	5,807,220	10.73	48,337,787	89.27

TELEPHONE INSTRUMENT RENTAL.

Chicago Intrastate.

	1923	1924	1925	1926	1927
Return allowed by Dist. Ct. (Appendix to Appellants' Brief, p. 54)	$ 158,069	$ 183,964	$ 197,531	$ 196,775	$ 177,148
Instrument Taxes (R. IV, 2933-5, Apportionment on Intrastate % shown above)	40,064	50,790	59,246	1,471	57
Return after deducting Taxes	$ 118,005	$ 133,174	$ 138,285	$ 195,304	$ 177,091
Investment less Depreciation Reserve (R. IV, 2945, Apportionment on Intrastate % shown above)	1,035,373	1,182,262	1,306,554	1,433,562	1,407,773
Rate of Return					
Before deducting taxes	15.27%	15.56%	15.12%	13.73%	12.58%
After deducting taxes	11.40%	11.26%	10.58%	13.62%	12.58%
Return after deducting taxes	$ 118,005				
Deduct difference between Appellee's Book Depreciation and District Court's allowance (*Infra*, 101)	20,344				
Return on basis of Dist. Court's allowance of Dep'n. Exp. Charges	$ 97,661				
Return on Investment	9.43%				

TELEPHONE INSTRUMENT INVESTMENT.

Investment in Instruments less Depreciation Reserve

	1923	1924	1925	1926	1927
American Company Total (R. IV, 2945)					
Investment	$31,329,013	$35,531,013	$35,373,616	$43,403,336	$42,848,662
Depreciation Reserve	15,010,382	16,611,453	18,387,618	20,304,999	20,441,625
Net	$16,318,631	$18,920,431	$20,985,998	$23,098,337	$22,407,037
Chicago Area Ratios (R. IV, 2945)	6.59604%	6.4961%	6.49675%	6.49675%	6.59604%
Chicago Area					
Investment	$ 2,066,474	$ 2,308,187	$ 2,558,005	$ 2,819,806	$ 2,826,315
Depreciation Reserve	990,091	1,079,097	1,194,597	1,319,165	1,348,338
Net	$ 1,076,383	$ 1,229,090	$ 1,363,408	$ 1,500,641	$ 1,477,977
Intrastate Ratios (*Supra*, 99)	96.19%	96.19%	95.83%	95.53%	95.25%
Intrastate					
Investment	$ 1,987,741	$ 2,220,245	$ 2,451,336	$ 2,693,760	$ 2,692,065
Depreciation Reserve	952,368	1,037,983	1,144,782	1,260,198	1,284,292
Net	$ 1,035,373	$ 1,182,262	$ 1,306,554	$ 1,433,562	$ 1,407,773
Rate Base (Chicago Area) (R. IV, 2940)					
Average Current Cost	$ 2,366,891	$ 2,699,950	$ 2,939,714	$ 3,054,103	$ 3,046,359
6% Reserve Stock	142,013	161,997	176,383	183,246	182,782
Total	$ 2,508,904	$ 2,861,947	$ 3,116,097	$ 3,237,349	$ 3,229,141
Depreciation 8%	200,712	228,956	249,288	258,988	258,331
Rate Base	$ 2,308,192	$ 2,632,991	$ 2,866,809	$ 2,978,361	$ 2,970,810
Intrastate Ratios (*Supra*, 99)	96.19%	96.19%	95.83%	95.53%	95.25%
Rate Base (Intrastate)					
Average Current Cost	$ 2,276,712	$ 2,597,082	$ 2,817,128	$ 2,917,585	$ 2,901,657
6% Reserve Stock	136,603	155,825	169,028	175,054	174,100
Total	$ 2,413,315	$ 2,752,907	$ 2,986,156	$ 3,092,639	$ 3,075,757
Depreciation 8%	193,064	220,233	238,893	247,410	246,061
Rate Base	$ 2,220,251	$ 2,532,674	$ 2,747,263	$ 2,845,229	$ 2,829,696

TELEPHONE INSTRUMENT DEPRECIATION.

Chicago Intrastate.

	1923	1924	1925	1926	1927
Depreciation Charge per Books (R. III, 2409)	$ 135,344	$ 149,389	$ 164,862	$ 181,235	$ 197,969
Depreciation Charge per Dist. Ct. (R. III, 2510)	115,000	128,000	141,000	155,000	169,000
Reduction from Book Charge	$ 20,344	$ 21,389	$ 23,862	$ 26,235	$ 28,969
Cumulative effect of above reduction on Average Depreciation Reserve (½ of current year plus sum of all prior years)	10,172	31,039	53,664	78,712	106,315
Dep. Reserve per Books (*Supra*, 100)	952,368	1,037,983	1,144,782	1,260,198	1,284,292
Dep. Res. adjusted to basis of Court's deprec. allowance	942,196	1,006,944	1,091,118	1,181,486	1,177,977
Investment (*Supra*, 100)	1,987,741	2,220,245	2,451,336	2,693,760	2,692,065
Ratio of Adjusted Dep. Res. to Investment*	47.40%	45.35%	44.51%	43.86%	43.76%
Current Cost (incl. 6% Reserve Stock (*Supra*, 100)	2,413,315	2,752,907	2,986,156	3,092,639	3,075,757
Depreciation which should have been deducted based on above ratios	1,143,911	1,248,443	1,329,138	1,356,431	1,345,951
Depreciation deducted by Appellee (*Supra*, 100)	193,064	220,233	238,893	247,410	246,061
Additional Amount of Depreciation that should have been deducted	$ 950,847	$1,028,210	$1,090,245	$1,109,021	$1,099,890
6% Return on Additional Depreciation Deduction	57,051	61,693	65,415	66,541	65,993

*The average for the period was 44.83%.

FAIR RETURN ON INSTRUMENTS AS ALLOWED BY DISTRICT COURT COMPARED WITH SIX PER CENT ON VALUE CLAIMED BY APPELLEE.

Year (a)	Value Claimed by Appellee (*Supra*, 100) (b)	Return Allowed by District Court (Appendix to Appellant's Brief, p. 54) (c)	Six Per Cent Return (on Col. (b)) (d)	Excess of Court's Allowance Over 6% (e)
1923	$2,220,251	$158,069	$133,215	$24,854
1924	2,532,674	183,964	151,960	32,004
1925	2,747,263	197,531	164,836	32,695
1926	2,845,229	196,775	170,714	26,061
1927	2,829,696	177,148	169,782	7,366

INFLATION OF INSTRUMENT RENTAL
CHICAGO INTRASTATE

Item	1923	1924	1925	1926	1927
1. Excess on account of using 8% Depreciation instead of amount indicated by percentage of reserve (a) (*Supra*, 101)	$ 57,051	$ 61,693	$ 65,415	$ 66,541	$ 65,993
2. Excess on account of using current cost instead of book cost (6% of Item 16)	25,534	31,960	32,089	23,933	23,022
3. Adjustment of Item 1, to basis of Book Depreciation Reserve (a) (6% of Item 19)	12,103*	14,490*	14,281*	10,495*	10,078*
4. Excess return allowed by District Court over 6% on Value claimed by Appellee (*Supra*, 101)	24,854	32,004	32,695	26,061	7,366
5. Sub Total	$ 95,336	$ 111,167	$ 115,918	$ 106,040	$ 86,303
6. Taxes (*Supra*, 99)	40,064	50,790	59,246	1,471	57
7. Total	$ 55,272	$ 60,377	$ 56,672	$ 104,569	$ 86,246
8. Return allowed by Dist. Court (Appendix to Appellants' Brief, p. 54)	$ 158,069	$ 183,964	$ 197,531	$ 196,775	$ 177,148
9. Book Cost (*Supra*, 100)	1,987,741	2,220,245	2,451,336	2,693,760	2,692,065
10. Depreciation reserve adjusted to Dist. Court's allowance (*Supra*, 101)	942,196	1,006,944	1,091,118	1,181,486	1,177,977
11. Difference	$1,045,545	$1,213,301	$1,360,218	$1,512,274	$1,514,088
12. 6% return on Item 11	62,733	72,797	81,613	90,735	90,845
13. Total Excess (Item 5) (8-12)	$ 95,336	$ 111,167	$ 115,918	$ 106,040	$ 86,303
14. Average Current Cost, Plus 6% Reserve Stock (*Supra*, 100)	$2,413,315	$2,752,907	$2,986,156	$3,092,639	$3,075,757
15. Investment (*Supra*, 100)	1,987,741	2,220,245	2,451,336	2,693,760	2,692,065
16. Difference	$ 425,574	$ 532,662	$ 534,820	$ 398,879	$ 383,692
17. Depreciation that should have been deducted (*Supra*, 101)	$1,143,911	$1,248,443	$1,329,138	$1,356,431	$1,345,951
18. Depreciation adjusted to Dist. Court's allowance (*Supra*, 101)	942,196	1,006,944	1,091,118	1,181,486	1,177,977
19. Difference	$ 201,715	$ 241,499	$ 238,020	$ 174,945	$ 167,974

(a) After giving effect to District Court's adjustment of Depreciation Expense from 7% to 6%.

* Red.

COMPARISON BETWEEN ASSOCIATED COMPANIES' SHOWING, COMMISSION'S ALLOWANCES, FOR RENTAL, AND RETURN TO AMERICAN COMPANY RESULTING THEREFROM.

Company and Commission	Associated Companies' Showing of Annual Cost on Telephone Instruments Per Station	Commission's Allowance for Rental	American Company's Actual Annual Cost on Telephone Instruments (Including Cost of Funds) Per Station*	American Company's Return on Property Investment Resulting from Showing or Allowance*
		YEAR 1920		
Central Union Tel. Co. (Ind. P. S. C.; P. U. R. 1920B, 913)	$ .96	.....	$ .3883	48.19%
Chesapeake & Pot. Tel. Co. (N. Y.) (D. C. P. U. C.; P. U. R. 1920D, 614)	....	$1.13	.3883	60.71%
Michigan State Tel. Co. (Mich. P. U. C. Order Jan. 17, 1920)	1.34	....	.3883	76.17%
Chesapeake & Pot. Tel. Co. (Va.) (Pa. P. S. C.; P. U. R. 1920F, 49)	1.13	1.13	.3883	60.71%
Southwestern Bell Tel. Co. (Ark. C. C.; P. U. R. 1921B, 516)	....	1.24	.3883	68.81%
Chicago Tel. Co. (Ind. P. S. C. Order Jan. 17, 1920)	....	1.13	.5164**	51.28%
Appellee (Ill. P. U. C. Order Dec. 20, 1920)	....	1.13	.5164**	51.28%
Chesapeake & Pot. Tel. Co. (W. Va.) (W. Va. P. S. C.; P. U. R. 1921B, 97)	....	1.00	.3883	51.14%
		YEAR 1921		
Indiana Bell Tel. Co. (Ind. P. S. C.; P. U. R. 1922E, 46)	1.12	....	.4336	52.85%
	....	1.08	.4336	50.16%
		YEAR 1922		
Cumberland Tel. & Tel. Co. (La. P. S. C. Order May 13, 1922)	1.36	....	.4809	63.17%
	....	1.00	.4809	40.13%
Indiana Bell Tel. Co. (Ind. P. S. C.; P. U. R. 1922E, 46)	.99	....	.4809	39.49%
	....	1.00	.4809	40.13%

*Computed from R. IV, 2933-9, 2945; R. V, 3754A; R. VI, 4009-19; R. VII, 4060b; R. IX, 4974-85, 5018A.

**Includes reimbursements by the American Company of taxes on instruments paid by the Appellee, which arrangement was not in effect in respect to the other Associated Companies.

Company and Commission	Associated Companies' Showing of Annual Cost on Telephone Instruments Per Station	Commission's Allowance for Rental	American Company's Actual Annual Cost on Telephone Instruments (Including Cost of Funds) Per Station*	American Company's Return on Property Investment Resulting from Showing or Allowance*
		YEAR 1922.		
Michigan State Tel. Co. (Mich. P. U. C.; P. U. R. 1923A, 30, approved in City of Detroit v. Michigan, etc., 209 Mich. 395)	....	.41¼	.4809	2.52%
		YEAR 1923.		
New York Tel. Co. (N. Y. P. U. C.; P. U. R. 1923B, 545, approved in N. Y. Tel.	1.08	....	.4485	45.71%
Co. v. Prendergast, 36 Fed.	1.19	....	.4485	52.48%
(2nd) 54)	....	1.00	.4485	40.79%
Indiana Bell Tel. Co. (Ind. P. S. C.; P. U. R. 1924A, 1, approved in Indiana Bell Tel. Co. v. Public Service Commission, 300 Fed. 190)	....	.50	.4485	10.04%
		YEAR 1925		
New England Tel. & Tel. Co. (Me. P. U. C.; P. U. R. 1926B, 247)	.97	.97	.5068	32.73%
		YEAR 1926		
Wisconsin Tel. Co. (Wis. R. R. C.; P. U. R. 1927A, 581)	.97	....	.5242	30.94%
	....	.70	.5242	16.34%

*Computed from R. IV, 2933-9, 2945; R. V, 3754A; R. VI, 4009-19; R. VII, 4060b; R. IX, 4974-85, 5018A.

**Includes reimbursements by the American Company of taxes on instruments paid by the Appellee, which arrangement was not in effect in respect to the other Associated Companies.

Appellee's Claim in Respect to Franchise, Excise and Capital Stock Taxes.

	Chicago Area	Chicago Intra-State	
	R. IV, 2933-7.	(*Supra*, 99) Ratio	Amount
1923	$59,564	96.19%	$57,295
1924	64,666	96.19	62,202
1925	75,021	95.83	71,893
1926	55,067	95.53	52,606
1927	39,984	95.25	38,086
1928	32,659	93.67	30,592
1929	33,898	88.97	30,159
1930	35,044	89.03	31,164
1931	44,310	89.27	39,556

RECONCILIATION OF DISTRICT COURT'S FINDINGS OF FAIR RETURN AND DEPRECIATION EXPENSE ALLOWANCE COVERING TELEPHONE INSTRUMENTS.

(Chicago Intrastate)

Appellee's Claim. FAIR RETURN	1923	1924	1925	1926	1927
1. Maintenance. (R. III, 2408)	$ 68,931	$ 83,036	$100,469	$126,225	$129,852
2. Depreciation (7% on current value new, *supra*, 100)	168,931	192,704	209,032	216,484	197,969
3. Return (8% on current value less 8% Depreciation, *supra*, 100)	177,620	202,614	219,781	227,618	236,034
4. Total (R. III, 2411)	415,482	478,354	529,282	570,327	563,855
From above Total the District Court apparently deducted the following:					
5. Maintenance (R. III, 2408)	68,931	83,036	100,469	126,225	129,852
6. Depreciation on Book Cost (R. III, 2409) (7%)	135,344	149,389	164,862	181,235	197,969
7. Total Deductions	204,275	232,425	265,331	307,460	327,821
8. Remainder	211,207	245,929	263,951	262,867	236,034
9. The District Court apparently assumed this Remainder to be the 8% return claimed by Appellee and therefore reduced it by 25% thereof to equal a return of 6% which produced the following amounts	158,405	184,447	197,963	197,150	177,026
10. Amounts allowed for Return by the District Court in its rounded out total of Maintenance, Depreciation and Return (Appendix to Appellants' Brief, p. 54) (R. III, 2510)	158,069	183,964	197,531	196,775	177,148
11. Rate of Return allowed	7.12%	7.26%	7.19%	6.92%	6.26%

Excess of District Court's Finding of Fair Value Over Capitalization.

CHICAGO INTRASTATE.

1931.

Fair Value (R. III, 2515)	$179,100,000
Funded and Misc. Debt (*Infra*, 109)	34,355,705
	$144,744,295
Capital Stock (*Infra*, 109)	87,045,349
Excess over Capital Stock	$ 57,698,946
Surplus (*Infra*, 109)	13,542,440
Excess over Capital Stock and Surplus	$44,156,506

ANALYSIS OF RETURN ON CAPITAL STOCK RESULTING FROM DISTRICT COURT'S FINDING OF MINIMUM RETURN. CHICAGO INTRASTATE. 1931.

	Value (1)	6½% Return on Value (2)	Resulting Return on Capital Stock After Paying Interest, (3)
(1) Capital Stock ,Infra, 109)..	$ 87,045,349	$ 5,657,948	6.50
(2) Surplus (Infra, 109).....	13,542,440	880,259	1.01
(3) Total Capital and Surplus...	$100,587,789	$ 6,538,207	7.51
(4) Funded Debt (Infra, 109)..	26,589,626	1,728,326	.27 (a)
(5) Misc. Indebtedness (Infra, 109)	7,766,079	504,795	.07 (b)
(6) Total Capitalization (Infra, 109)	$134,943,494	$ 8,771,328	7.85
(7) Excess of Appellants' Rate Base over Capitalization..	23,869,773	1,551,535	1.78
(8) Total Appellants' Rate Base (Appendix to Appellants' Brief, p. 88).....	$158,813,267	$10,322,863	9.53
(9) Additional Value allowed by District Court over Appellants' Rate Base	20,286,733	1,318,637	1.52
(10) District Court's Fair Value (R. III, 2515).....	$179,100,000	$11,641,500	11.15

(a) After deducting Interest and Amortization of $1,492,670 (Infra, 109).

(b) After deducting Interest of $441,113 (Infra, 109).

Net Amount Remaining for Surplus Resulting from District Court's Finding of Minimum Return.

CHICAGO INTRASTATE.

1932.

1. Fair Value found by Dist. Ct. (R. III, 2515)	$166,500,000
2. Fair Rate of Return as found by Dist. Ct. (R. III, 2521).....	5.5%
3. Amount of Return (2 x 1).....	$ 9,157,500
4. Interest, amortization of discount and 8% Dividend Requirements (based on 1931—*infra*, 109)	8,897,217
5. Amount Remaining for Surplus.....	$260,283

ILLINOIS BELL TELEPHONE CO.
Funds Used in Business.
1931.

	Entire Company			Chicago Area			Chicago Intrastate	
		Average Invest. or Funds	Interest and Dividends		Average Invest. or Funds	Interest and Dividends	Average Invest. or Funds	Interest and Dividends
Fixed Capital (R. VII, 4078-9)								
Jan. 1	$282,948,223			$191,286,165				
Dec. 31	290,594,688			195,422,114				
	$573,542,911	$286,771,456		$386,708,279	$193,354,140			
Fixed Capital Reserves (R. VII, 4075)								
Jan. 1	$ 63,966,749			$ 51,469,803				
Dec. 31	69,242,666			54,942,489				
	$133,209,415	66,604,708		$106,412,292	53,206,146			
Fixed Capital, after deducting Reserve		$220,166,748			$140,147,994			
Work in Progress (R. IV, 2782b, 2779)								
Jan. 1	$ 5,436,845			$ 4,415,765				
Dec. 31	664,892			441,956				
	$ 6,101,737	3,050,869		$ 4,857,721	2,428,861			
Total Fixed Capital and Work in Progress, after deducting Reserve		$223,217,617			$142,576,855			
Ratios		100.00%			63.873%		90.85%	(a) (Of Chicago Area)

Capital Stock, including Premiums (R. VIII, 4793-4)							
Jan. 1	$150,004,168						
Dec. 31	150,004,168						
	$300,008,336	$150,004,168	$12,000,000	95,812,162	7,664,760	$ 87,045,349	$6,963,434
Capital Stock Installments (R. VIII, 4793-4)		.....		.....		.....	
Funded Debt, less discount (R. VIII, 4793-4)							
Jan. 1	$ 45,833,026						
Dec. 31	45,810,129						
	$ 91,643,155	45,821,578	2,572,300	29,267,613	1,643,005	26,589,626	1,492,670
Other Interest Bearing Obligations...		13,383,187(b)	760,165	8,548,243	485,540	7,766,079	441,113
		$209,208,933	$15,332,465	$133,628,018	$8,793,305	$121,401,054	$8,897,217
Surplus (R. VIII, 4793-4)							
Jan. 1	$ 22,907,655						
Dec. 31	23,767,381						
	$ 46,675,036	23,337,518		14,906,373		13,542,440	
		$232,546,451		$148,534,391		$134,943,494	

(a) Ratio based on R. IV, 2756, line 15.
(b) Computed by dividing interest, by 1930 interest rate (5.68%), assumed to be the same for 1931 (R. VIII, 4461).

IN THE DISTRICT COURT OF THE UNITED STATES
FOR THE EASTERN DISTRICT OF ILLINOIS.

KANKAKEE WATER COMPANY, a corporation, vs. G. GALE GILBERT, et al.	In Equity No. 514-D.

FINDINGS OF FACT AND CONCLUSIONS OF LAW UPON HEARING UPON APPLICATION FOR TEMPORARY INJUNCTION.

The motion for temporary injunction came on to be heard on December 21st, and after hearing the evidence and statements of counsel was taken under advisement.

After due consideration, the court enters the following findings:

(1) The jurisdictional and historical facts are not in dispute; hence there is no necessity of repetition thereof.

(2) The ultimate question submitted is whether plaintiff's property is being unconstitutionally confiscated, and depends upon two material sub-questions, viz: is the valuation of plaintiff's property by the Illinois Commerce Commission a fair and reasonable one, and, if so, is the probable return of approximately 5.17% upon said valuation, furnished by the rates fixed by said commission, such as to constitute confiscation of property.

(3) The commission apparently considered the testimony of three engineers, one employed by the City of Kankakee, one by the plaintiff, and one by the commission. The respective valuations placed upon plaintiff's property by these three gentlemen, exclusive of allowance for a going concern, were $1,018,926; $1,074,390 and $1,236,271. The commission fixed the fair value, including an allowance for a going concern, at $1,200,000. Plaintiff now claims in its bill and ex parte affidavits, that its property is of a value in excess of $1,500,000.

(4) The only evidence of value submitted to the court, in accordance with the usual practice, is that of affidavits and counter affidavits. Without an opportunity to hear tes-

timony and pass upon the credibility of witnesses, we do not find in the record sufficient evidence to warrant an affirmative finding that the valuation fixed by the commission is unfair or unreasonable.

(5) Under the existing generally depressed industrial and financial conditions, indicating a greatly abnormal condition both generally and locally, all of which appears in the record, we are not warranted in finding that the probable return of 5.17% upon the valuation, as aforesaid, furnished by the commission's prescribed rates, is confiscatory. In this connection, we have considered the evidence of present return in industrial enterprises of other character, and that of similar utility companies, as well as the fact that plaintiff makes no claim and furnishes no evidence that new capital is at present needed in its business.

(6) There are various subsidiary questions involved, such as the propriety of certain charges included by plaintiff in its accounting upon disbursements; original cost, present cost of reproduction, prematureness of this application and other important elements involved upon which, as in the matter of valuation and return, we are not satisfied with the sufficiency of the evidence to warrant affirmative findings of fact upon this interlocutory hearing. We prefer to dispose of them at final hearing, for which the court will furnish prompt opportunity upon settlement of issues herein.

CONCLUSIONS OF LAW.

We conclude, therefore, that there being insufficient evidence upon which to base affirmative findings of unreasonable valuation or confiscation, the motion for a temporary injunction should be denied. It is so ordered.

Entered January 6, A. D. 1933.

EVAN A. EVANS,
Circuit Judge.

JAMES H. WILKERSON,
District Judge.

WALTER C. LINDLEY,
District Judge.

STATION APPARATUS—CHICAGO DIVISION.
Gross Additions, Retirements, Net Loss and Depreciation Accruals 1921 to 1931, Inclusive.*

Year	Gross Additions	Retirements	Net Loss	Depreciation Accruals
1921	$1,142,531	$ 564,280	$ 103,217**	$ 463,462
1922	1,551,180	916,194	3,084	514,455
1923	2,262,763	1,184,968	59,727	585,154
1924	2,573,514	1,415,776	173,446	570,752
1925	2,945,003	1,905,584	122,188	634,399
1926	3,113,065	2,148,598	376,765	693,802
1927	5,893,658	2,396,145	19,865**	762,879
1928	5,260,510	4,126,570	664,420	1,089,166
1929	5,182,765	4,431,767	1,140,004	1,148,120
1930	4,445,243	4,855,098	1,588,036	1,182,551
1931	4,694,615	5,143,412	1,340,357	1,154,230

*Sources: R. IV, 2776a, 2776b, 2777.
**Red figure.

SUPREME COURT OF THE UNITED STATES.

Nos. 440 and 548.—October Term, 1933.

Benjamin F. Lindheimer and others, constituting the Illinois Commerce Commission of the State of Illinois; Otto Kerner, Attorney General of the State of Illinois, and the City of Chicago, Appellants, 440 *vs.* Illinois Bell Telephone Company. Illinois Bell Telephone Company, Appellant, 548 *vs.* Benjamin F. Lindheimer and others, constituting the Illinois Commerce Commission of the State of Illinois; Otto Kerner, Attorney General of the State of Illinois, and the City of Chicago.	Appeals from the District Court of the United States for the Northern District of Illinois.

[April 30, 1934.]

Mr. Chief Justice Hughes delivered the opinion of the Court.

This case comes here for the second time. It presents the question of the validity under the Fourteenth Amendment of rates prescribed by the Illinois Commerce Commission for telephone service in the City of Chicago. The Commission's order, made on August 16, 1923, to be effective October 1, 1923, reduced rates applicable to a large part of the intrastate service of the appellee, Illinois Bell Telephone Company.[1] In this suit, brought by that Company in September, 1923, an interlocutory injunction was granted upon the condition that if the injunction were dissolved the Company should refund the amounts charged in excess of the challenged rates. We affirmed that order. 269 U. S. 531. The

[1]The order reduced rates for four classes of coin box service. Otherwise it kept in force the rates which were fixed by an order of December 20, 1920. The coin boxes are in private residences and places of business, and are not public pay stations.

final hearing was not had until April, 1929,—a delay found to be attributable to the City of Chicago. On that hearing, the District Court, composed of three judges, entered a final decree making the injunction permanent. 38 F. (2d) 77. We reversed that decree and remanded the case for further proceedings. *Smith* v. *Illinois Bell Telephone Company*, 282 U. S. 133. Further evidence was then taken and the District Court made new findings and entered a final decree which permanently restrained the enforcement of the Commission's order and released the Company from obligation to refund the moneys which had been collected pending the suit. 3 F. Supp. 595. The state authorities and the city bring this direct appeal. Jud. Code, sec. 266. The Company brings a cross-appeal to review the findings below, insisting that its property has been undervalued and that substantial amounts of its operating expenses have been disallowed.

No. 440.—The appeal of the State officers and the City of Chicago. On the former appeal, it appeared that no distinction had been made by the Commission or by the District Court between the intrastate and the interstate property and business of the Company. We found that separation was essential to the appropriate recognition of the competent governmental authority in each field of regulation. Accordingly, we directed that as to the value of the property employed in the intrastate business in Chicago and as to the amounts of revenue and expenses incident to that business, separately considered, there should be specific findings. And as a rate order which is confiscatory when made may cease to be confiscatory, and one which is valid when made may become confiscatory at a later period, we held that there should be appropriate findings for each of the years since the date of the Commission's order. 282 U. S. pp. 149, 162. On the further hearing, that difficult task was so well performed that no question is now raised as to the allocation of property to the intrastate and interstate services, respectively, in the Chicago area, the allocation being made on the basis of use.[2] Nor is there dispute with respect to the separation of expenses. Appellants object to the separation of

[2]It appears that in 1923 there was used in the intrastate service approximately 95 per cent. of appellee's total property in the Chicago area. This percentage progressively decreased in the succeeding years, and in 1931 was somewhat less than 91 per cent.

revenues, insisting that certain revenues were improperly assigned to the interstate, instead of the intrastate, business.[3]

Considering the fact that ninety-nine per cent of the stock of appellee is owned by the American Telephone & Telegraph Company which also owns substantially the same proportion of the stock of the Western Electric Company, we directed that there should be further examination of the purchases made by appellee from the Western Electric Company and of the payments made by appellee to the American Company. As it appeared that the Western Electric Company, through the organization and control of the American Company, was virtually the manufacturing department for the Bell system, we directed specific findings to be made as to the net earnings of the Western Electric Company in that department and as to the extent to which, if at all, such profit figured in the estimates upon which the charge of confiscation was predicated. We also held that there should be specific findings with regard to the cost to the American Company of the services which it rendered to appellee and the reasonable amount which should be allocated in that respect to the operating expenses of appellee's intrastate business. *Id.*, pp. 153, 157. The District Court entered into an exhaustive examination of these questions and made detailed findings. The court found that the equipment and supplies furnished by the Western Electric Company had been sold to appellee at fair and reasonable prices, and that the earnings of the Western Electric Company on its investment allocated to the business done with appellee, and its profits on sales, had been fair and reasonable, with the exception of an advance in prices of 10.2 per cent. effective on November 1, 1930. That advance the court disapproved, and, in determining the reasonable outlays to be allowed to appellee after that date, the court made a reduction of 10 per cent. from the prices charged by the Western Electric Company.[4] Appellee contests this reduction, and appellants object to the amounts allowed.

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[3]The amounts of net revenue thus involved, which appellants contend should not have been allocated (under the rates in suit) to the interstate service for the respective years, are as follows: 1923, $245,042; 1924, $262,398; 1925, $309,505; 1926, $317,915; 1927, $354,372; 1928, $427,655; 1929, $486,875; 1930, $472,469; 1931, $431,580.

[4]Appellee states that this effected a reduction in the operating expenses of appellee of $67,167 for the last two months of 1930, $332,470 for 1931, and an equal amount for 1932.

The District Court made specific findings as to the character of the services rendered by the American Company under its license contracts with appellee and the amounts of the cost of these services which should be allocated to the operating expenses of the latter's intrastate business. In the years 1923 to 1928, inclusive, when the court found that the payments under the license contracts charged on appellee's books exceeded the cost as thus determined and allocated, only the cost was held to be chargeable to operating expenses, but in the years 1929 to 1931, inclusive, when the license payments as so charged were less than the cost, only the amount of the license payments was allowed as an operating expense.[5] Appellants raise many questions in opposition to these determinations of costs and allocations, while appellee contends that the costs as found were less than the true costs and that the full amounts paid under the license contracts should have been allowed.

The evidence with respect to the value of appellee's property employed in its intrastate business at Chicago is voluminous. The evidence shows the original or book cost of this property, the market value of land, and estimates of the cost of reproduction new of the other physical property constituting appellee's telephone plant. There was also evidence of the condition of the property, together with estimates of accrued depreciation. Appellants submitted no valuations since one made by the Commission in 1923,[6] but presented detailed criticisms of appellee's estimates. The District Court found that the method adopted by appellee's witness in ascertaining the cost of reproduction new was reliable and that appellee's estimates were substantially correct. The court encountered difficulties in making its valuations for the years 1931 and 1932. It took notice of the general fall in values which had accompanied the depression in business. And for that reason, the court fixed values for 1931 and 1932 which in its opinion "gave due consideration to the element of the present decline". The court found that the fair rate of depreciation to be applied to re-

[5]The amounts of the license payments thus disallowed by the Court, as being in excess of the cost of the service, for the years 1923 to 1928, inclusive, are as follows: 1923, $573,819; 1924, $631,549; 1925, $531,233; 1926, $432,704; 1927, $558,011; 1928, $31,553. The amounts by which the cost to the American Company exceeded the license payments, for the years 1929 to 1931, are as follows: 1929, $206,253; 1930, $327,751; 1931, $234,104.

[6]See 38 F. (2d) p. 86; 282 U. S. pp. 144, 145.

production cost new was 16 per cent. for the years 1923 to 1928, inclusive, and 15 per cent for the succeeding years; and that the amount to be added to reproduction cost new on account of going value was 8 per cent. of that cost. The court also made findings as to the appellee's working cash capital, the amounts invested in materials and supplies and in property in course of construction, and as to these three items there is no controversy.

The court's findings, for each year, of the fair value of appellee's property, used and useful in its intrastate business in the Chicago area, including working cash capital, materials and supplies, construction work in progess and going value, taking the average amount for the year, and the court's findings as to the original or average book cost of the same property, but without going value, are as follows:

	Fair Value	*Book Cost*
1923	$124,200,000	$95,074,135
1924	136,500,000	105,291,980
1925	148,500,000	117,730,536
1926	151,500,000	130,857,355
1927	167,000,000	146,173,197
1928	173,000,000	159,622,212
1929	184,000,000	168,988,816
1930	187,120,000	178,157,620
1931	179,100,000	181,925,963
1932	166,500,000	181,925,963

Appellants contend that the findings as to fair value are excessive. Appellee insists that they are too low. In particular, appellee says that the property was undervalued through excessive deductions for existing depreciation. Appellee maintains that the evidence shows a maximum depreciation of 9 per cent. for the years 1923 to 1928, and of 8 per cent. thereafter, instead of the 16 per cent. and 15 per cent. deducted by the court.

In computing the net revenue from the intrastate business in Chicago, the court made adjustments in operating expenses with respect to the payments to the Western Electric Company and the American Company, as above stated, and also reduced to some extent the annual charges for depreciation. By these adjustments, the amount of the net revenue as found by the court largely exceeded that shown by appellee's books. For example, the amount available for return in the year 1923 under the existing rates appears to have been $5,347,533 according to appellee's books, while the amount found by the court to have been available for return in that year is $6,646,183. We shall presently refer to the comparison for the other years.